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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Commonwealth of Massachusetts (Commonwealth) have been prepared in accordance with accounting principles generally accepted in the United States of America, (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The significant Commonwealth accounting policies are described below. Except where noted, all numbers in the footnotes and other sections of this Comprehensive Annual Financial Report are in thousands.

A. Reporting Entity

The Commonwealth is comprised of three branches: the Executive Branch, with the Governor as the chief executive officer; the Legislative Branch, consisting of a Senate of 40 members and a House of Representatives of 160 members; and the Judicial Branch made up of the Supreme Judicial Court, the Appeals Court and the Trial Court. In addition, the Legislature has established 56 independent authorities and agencies. Below the level of state government are county governments and 351 cities and towns exercising the functions of local governments. The cities and towns of the Commonwealth are also organized into 14 counties, but county government has been abolished in seven of those counties in recent years.

For financial reporting purposes, the Commonwealth has included all funds, organizations, account groups, agencies, boards, commissions and institutions. The Commonwealth has also considered all potential component units for which it is financially accountable as well as other organizations for which the nature and significance of their relationship with the Commonwealth is such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. As required by GAAP, these financial statements present the Commonwealth of Massachusetts (the primary government) and its component units. The Commonwealth has included 35 entities as component units in the reporting entity because of the significance of their operational and/or financial relationships with the Commonwealth.

i. Component Units and Details of Departments and Funds that are Separately Audited

Blended Component Units, Departments and Funds that are Separately Audited – Blended component units are entities that are legally separate from the Commonwealth, but are so related to the Commonwealth, that they are, in substance, the same as the Commonwealth or entities providing services entirely or almost entirely to the Commonwealth. The net assets and results of operations of the following legally separate entities are presented as part of the Commonwealth's operations:

- **The Pension Reserves Investment Trust Fund (PRIT)** is the investment portfolio for the pension net assets of the Commonwealth and as such, is presented as a blended component unit. PRIT is managed by the Pension Reserves Investment Management (PRIM) Board.
- **The Health Care Security Trust Account (HST)** is the long - term investment account of the Health Care Security Trust (HCST) a minor governmental fund. The Health Care Security Trust was the recipient of tobacco settlement remittances to the Commonwealth from fiscal 1999 through fiscal 2002. The HCST is managed by a board of trustees, which supervises the investment and reinvestment of monies received into the HCST. The HCST utilizes certain resources and staff

of PRIT or PRIM. In fiscal 2003, all tobacco settlement remittances received in fiscal 2003 will be transferred to the tobacco settlement fund (also a minor governmental fund). Also certain other short – term Medicaid related revenues during fiscal 2003 through the Health Care Quality Improvement Fund (a minor governmental fund) will be managed by the HCST.

- **The Massachusetts Municipal Depository Trust (MMDT)** is an investment pool of the Commonwealth and its political subdivisions. Portions of MMDT are reported as an external investment trust within the fiduciary statement of net assets and statement of changes in net assets. MMDT is established by the Treasurer – Receiver General, who serves as trustee. The securities within the portfolio are valued on the basis of the amortized cost valuation method. Net interest income is determined at the close of business each day, and consists of interest accrued or discount earned, accumulated gains or losses on the portfolio and amortization of premiums and expenses. All income so determined is declared as a daily dividend to participants paid monthly. Participation is voluntary and units are unlimited.

The following departments are separately audited from the Commonwealth but are not legally separate from the Commonwealth:

- **The Massachusetts State Lottery Commission** runs the Commonwealth's lottery. The net assets of the Commission and results of operations are presented as part of the Commonwealth's governmental activities.
- **The Commonwealth of Massachusetts Owner Controlled Worker's Compensation and General Liability Insurance Program (OCIP)** provides worker's compensation and general liability insurance for all eligible contractors and subcontractors working on the Central Artery / Tunnel Project. The OCIP is managed by management of the Central Artery / Tunnel Project and is presented as a minor governmental fund within the governmental activities.

The institutions of higher education of the Commonwealth have operations and net assets that are presented as part of the Commonwealth's business – type activities. These systems include:

- **The University of Massachusetts System** including its discretely presented component units, the University of Massachusetts Building Authority, the University of Massachusetts Foundation, Inc., and the Worcester City Campus Corporation (doing business as Umass Health System.) The Worcester City Campus Corporation includes a not-for-profit subsidiary, the Worcester Foundation for Biomedical Research, Inc. Finally, the University System includes the University of Massachusetts Dartmouth Foundation, Inc.
- **The State and Community College System** includes 9 State and 15 Community Colleges located throughout the Commonwealth. The following are Community Colleges:
 - Berkshire Community College
 - Bunker Hill Community College
 - Bristol Community College
 - Cape Cod Community College
 - Greenfield Community College

- Holyoke Community College
- Massasoit Community College
- Massachusetts Bay Community College
- Middlesex Community College
- Mount Wachusett Community College
- Northern Essex Community College
- North Shore Community College
- Quinsigamond Community College
- Roxbury Community College
- Springfield Technical Community College

The following are State Colleges:

- Bridgewater State College
- Fitchburg State College
- Framingham State College
- Massachusetts College of Art
- Massachusetts Maritime Academy
- Massachusetts College of Liberal Arts
- Salem State College
- Worcester State College
- Westfield State College

Within the State and Community College system is a blended component unit, The Massachusetts State College Building Authority.

Discretely Presented Component Units that are Separately Audited – Discrete component units are entities which are legally separate (often called Authorities) are financially accountable to the Commonwealth, or whose relationships with the Commonwealth are such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. The component units column of the basic financial statements includes the financial data of the following entities:

Major Component Units:

- **The Massachusetts Bay Transportation Authority (MBTA)** provides mass transit facilities within the Greater Boston metropolitan area, comprising 78 cities and towns.
- **The Massachusetts Turnpike Authority (MTA)** operates the Massachusetts Turnpike and the Boston harbor tunnel crossings that are part of the Metropolitan Highway System.
- **The Massachusetts Water Pollution Abatement Trust (MWPAT)** provides a combination of federal and Commonwealth funds for water and sewer projects around the Commonwealth as operator of the Commonwealth's state revolving fund.

Minor Component Units

- **The Massachusetts Convention Center Authority (MCCA)**
- **The Massachusetts Development Finance Agency (MassDevelopment)**
- **The Massachusetts Technology Park Corporation (MTPC)**
- **The Massachusetts Community Development Finance Corporation (MCDFC)**
- **Commonwealth Corporation**
- **The Massachusetts International Trade Council, Inc. (MITC)**
- **The Community Economic Development Assistance Corporation (CEDAC)**

- **The Massachusetts Housing Partnership (MHP)**
- **Route 3 North Transportation Improvements Association (R3N)**
- **The Commonwealth Zoological Corporation**
- **The Regional Transit Authorities (15 separate entities) including:**
 - Berkshire Regional Transit Authority
 - Brockton Area Transit Authority
 - Cape Ann Transit Authority
 - Cape Cod Regional Transit Authority
 - Franklin Regional Transit Authority
 - Greater Attleboro / Taunton Regional Authority
 - Greenfield-Montague Transportation Area
 - Lowell Regional Transit Authority
 - Martha's Vineyard Transit Authority
 - Merrimack Valley Regional Transit Authority
 - Montachusett Regional Transit Authority
 - Nantucket Regional Transit Authority
 - Pioneer Valley Regional Transit Authority
 - Southeastern Regional Transit Authority
 - Worcester Regional Transit Authority

All of the component units, except for MTPC, were audited by a firm other than Deloitte & Touche, LLP.

ii. Related Organizations

The following are "related organizations" under GASB Statement No. 14, "*The Financial Reporting Entity*": Massachusetts Port Authority, Massachusetts Housing Finance Agency, Massachusetts Health and Educational Facilities Authority and Massachusetts Technology Development Corporation. The Commonwealth is responsible for appointing a voting majority of the members of each entity's board, but the Commonwealth's accountability does not extend beyond the appointments.

iii. Availability of Financial Statements

The Commonwealth's component units, Departments and Funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities. To obtain their phone numbers, you may contact the Office of the State Comptroller, Financial Reporting and Analysis Bureau, at (617) 973-2660.

iv. Program and Other Revenue Recognition

Program revenue is defined by the Commonwealth to be the revenue from fees and assessments collected by departments that are applicable to that department's operations. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs. Revenues and expenses of business type activities and proprietary funds are classified as operating or nonoperating and are subclassified by object. Operating revenues and expenses generally result from providing services and producing and delivering goods. All other revenues and expenses are reported as nonoperating.

B. Government – Wide and Fund Financial Statements

The Statement of Net Assets and the Statement of Activities report information on all non-fiduciary activities of the primary government (the Commonwealth), and its component units. Primary government activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

i. Government – Wide Financial Statements

The **Statement of Net Assets** presents the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- **Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for

bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.

- **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through enabling legislation.
- **Unrestricted net assets** consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. They often have resources that are imposed by management, but can be removed or modified.

The **Statement of Activities** demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are instead reported as general revenue.

ii. *Fund Financial Statements*

Separate financial statements are provided for governmental funds, proprietary funds and fiduciary funds, even though the latter are excluded from the government – wide statements. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column. The Commonwealth presents a balance sheet and a statement of revenues, expenditures and changes in fund balances for its governmental funds. The ending fund balance on the balance sheet is then reconciled to the ending governmental net assets. For the proprietary funds, a statement of net assets and a statement of changes in net assets is presented along with a statement of cash flows. As the business-type activities are presented in the same basis of accounting as the proprietary funds, no further reconciliation is necessary.

The Commonwealth reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

C. *Measurement Focus and Basis of Accounting - Government Wide*

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

Governmental Funds – account for the general governmental activities of the Commonwealth. Governmental fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become *susceptible to accrual*; generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Significant revenues susceptible to accrual include income, sales and use, corporation and other taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Revenues from other financing sources are

recognized when received. Expenditures are recorded in the period in which the related fund liability is incurred. Principal and interest on general long-term obligations are recorded as fund liabilities when due.

Business – type Activities – account for activities for which a fee is charged to external users for goods or services. In these services, debt may be issued backed solely by these fees and charges. There may be also a legal requirement or a policy decision to recover costs. As such, these funds account for operations similarly to a for – profit business. The Commonwealth’s Institutions of Higher Education’s operations are reported as systems within the proprietary funds.

**i. Measurement Focus
Basis of Accounting
– Fund Perspective**

The Commonwealth has established the following funds (further divided by fund types):

General Fund is the primary operating fund of the Commonwealth. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

Local Aid Fund accounts for the lottery operating surplus and forty percent of income and corporate taxes, thirty-two percent of sales tax and a portion of other taxes which have been earmarked for distribution to municipalities or used to finance programs that benefit local communities and a major portion of the court systems.

Lottery Funds account for the operations of the State and Arts Lotteries, which primarily finance the aforementioned local aid fund.

Debt Service Fund accounts for the accumulation of resources, principally transfers from other funds, for the payment of long-term debt principal and interest.

Capital Projects – Highway accounts for the proceeds of bonds sold to finance construction of state highways and to fund the Commonwealth’s share of Federally sponsored highway construction.

Capital Projects - Central Artery Statewide Roads and Bridges Fund accounts for the construction of a portion of the Central Artery / Tunnel project financed from fiscal 2001 forward, as well as various other statewide road and bridge projects. These expenditures are financed from bond proceeds, certain revenues from Registry of Motor Vehicles fees (net of debt service expenditures) and payments from authorities.

Teacher, Principal and Superintendent Quality Endowment Fund is an endowment of \$70 million administered by the commissioner of education. The fund consists of an initial appropriation, along with public and private gifts, grants and donations. Investment earnings of the fund are expended for high achieving teaching professionals in the Commonwealth who are awarded with \$5,000 salary bonuses from these earnings.

Additionally, the Commonwealth reports the following fund types:

Governmental Fund Types:

Special Revenue Funds account for specific revenue sources that have been aggregated according to Commonwealth Finance Law to support specific governmental activities.

Capital Projects Funds account for the acquisition or construction of major Commonwealth capital facilities financed primarily from bonds and federal reimbursements.

Permanent Funds report resources that are legally restricted to the extent that only earnings and not principal, may be used for purposes that benefit the government or its citizens.

Proprietary Fund Types:

Unemployment Compensation Fund reports the taxes collected from employers and held by the United States Treasury in the Federal Unemployment Trust Fund, from which funds are drawn for the payment of benefits to the unemployed.

College and University Information is presented here, aggregated by the University's activity, the State Colleges activity and the Community College's activity.

Fiduciary Fund Types:

Pension Trust Funds report resources that are required to be held in trust for the members and beneficiaries of the Commonwealth's pension plans. These include the State Employees' and Teachers' Retirement Systems and assets held in trust for the cities and towns.

External Investment Trust Funds account for the portion of pooled cash held under the custodianship of the Commonwealth for the benefit of cities, towns and other political subdivisions of the Commonwealth.

Private Purpose Funds account for various gifts and bequests held by the Commonwealth, of which only the income is expendable for purpose specified by the donor.

Agency Funds account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

As allowed by GASB statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, the Commonwealth's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

ii. Fiscal Year Ends

All funds and discretely presented component units are reported using fiscal years, which end on June 30, except for the Massachusetts Turnpike Authority which utilizes a December 31 year end.

**D. Assets, Liabilities and
Net Assets / Fund
Balance**

Cash and Short-Term Investments and Investments -

The Commonwealth follows the practice of pooling cash and cash equivalents for some of its Governmental and Fiduciary Funds. Cash equivalents consist of short-term investments with an original maturity of three months or less and are stated at cost or amortized cost, which approximates fair value. Interest earned on pooled cash is allocated to the General Fund and to certain Special Revenue Funds when so directed by law. All Commonwealth, Component Unit, Pension and Deferred Compensation Plan investments are carried at fair value determined by current market rates and quotations.

The Pension Trust Funds, with investments totaling approximately \$26,835,258,000, at fair value, are permitted to make investments in equity securities, fixed income securities, real estate, venture capital funds, real estate funds, limited partnerships, futures pools, international hedge pools, commodities pools, balanced pools, leveraged buyouts, private placements and other alternative investments. For investments traded in an active market, the fair value of the investment will be its market price. The structure, risk profile, return potential and marketability differ from traditional equity and fixed income investments. Concentrations of credit risk exist if a number of companies in which the Pension Trust Fund has invested, are engaged in similar activities and have similar economic characteristics that could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. To mitigate the exposure to concentrations of risk, the Pension Trust Funds invest in a variety of industries located in diverse geographic areas. As of June 30, 2002, the estimated fair value, determined by management with input from the investment managers, of these real estate and alternative investments was approximately \$3,500,739,000 in the Pension Trust Funds, representing 11.0%, of the total assets of the Fiduciary Fund Type.

Pension Trust Fund and External Investment Trust Fund net assets have been restricted as follows:

“Restricted for employee’s pension benefits” identifies resources held in trust for the members and beneficiaries of the Commonwealth’s pension plans.

“Restricted for external investment trust fund participants” identifies the portion of pooled cash held under custodianship of the Commonwealth for the benefit of cities, towns and other political subdivisions of the Commonwealth.

The Commonwealth maintains a short-term investment pool established by the State Treasurer on June 8, 1977 through a Declaration of Trust. The investments are carried at amortized cost, which approximates fair value. The primary government’s and component unit’s share are reported as short-term investments within their respective reporting categories. The various local governments and other political subdivisions share of net asset is approximately \$2,453,934,000 and is reported as an External Investment Trust within the Fiduciary Fund Type.

Included in the discretely presented Component Units is approximately \$1,095,950,000 in investments, whose valuation was determined by management. In making its valuations, management considered the cost of investments, current and past operating results, current economic conditions and their effect on the borrowers, estimated realizable values of collateral, and other factors pertinent to the valuation of investments. There is no public market for most of the investments. Management, in making its evaluation, has in many instances relied on financial data and on estimates by management of the companies they have invested in as to the effect of future developments.

Investments of the University of Massachusetts (UMass) are stated at fair value. Annuity contracts represent guaranteed investment contracts and are carried at present value.

E. *Securities Lending Program*

Under the securities lending programs, PRIT receives fees for allowing its lending agents to borrow from PRIT's public market equity and fixed income securities, respectively, for a predetermined period of time. These loans are secured with collateral (U.S. Treasury securities), typically equaling 102% of the market value of the domestic securities borrowed and 105% on borrowings of international securities. Pursuant to the Operations Support Agreements with PRIT's lending agents, Mellon Trust held all collateral for securities on loan at June 30, 2002. The collateral securities cannot be pledged or sold by PRIT unless the lending agent(s) default. The lending agents are required to indemnify PRIT in the event that they fail to return the securities on loan (and if the collateral is inadequate to replace the securities on loan) or if the lending agents fail to perform their obligations as stipulated in the agreements.

At June 30, 2002, the market value of the securities on loan was \$1,249,322,000 and the value of the collateral including accrued interest, amounted to approximately \$1,352,713,000. As of June 30, 2002, securities on loan are included in investments at fair value in the accompanying Statement of Fiduciary Net Assets.

F. *Receivables*

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts.

Reimbursements due to the Commonwealth for its expenditures on federally funded reimbursement and grant programs are reported as "Federal grants and receivables" or "Due from federal government."

G. *Due From Cities and Towns*

These amounts represent reimbursement due to the Commonwealth for its expenditures on certain programs for the benefit of cities and towns.

H. *Fixed Assets*

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the applicable governmental or business-type activity columns of the government-wide financial statements.

i. *Methods used to value capital assets*

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

ii. *Capitalization Policies*

All land, non-depreciable land improvements and donated historical treasures or works of art are capitalized, regardless of cost. Singular pieces of equipment, vehicles, computer equipment and software that equal or exceed \$50,000 (\$1,000 for the University of Massachusetts) are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$100,000 are capitalized. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

iii. Depreciation and useful lives

Applicable capital assets are depreciated using the straight-line method with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

<i>Type of Asset</i>	Estimated Useful Life (in years)
Buildings	40
Infrastructure - roads, bridges and tunnels	40
Infrastructure - beaches, boardwalks, bikeways, etc.	25
Infrastructure - dams, water and sewer systems	50
Furniture	10
Library collections that are not historical treasures	15
Equipment, office equipment and life safety equipment	10
Computer hardware and software	3 to 7
Vehicles	5

I. Interfund/Intrafund Transactions

Fixed assets of the Component Units are capitalized upon purchase and depreciated on a straight-line basis over the estimated useful lives of the assets. Interest incurred during construction is capitalized.

As a general rule, the effect of interfund activity has been eliminated in the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities.

Receivables and payables resulting from transactions between Component Units and the primary government are classified as "Due to/from primary government" or "Due to/from component units."

J. Statewide Cost Allocation Plan – Fringe Benefit Cost Recovery

Certain costs of nine "central service" agencies of the Commonwealth are recovered from the remaining agencies in a federally approved statewide cost allocation plan. These costs that are allocated are based upon benefits received by the user agency that benefits from these services. The Commonwealth also appropriates and pays the fringe benefit costs of its employees and retirees through the General Fund. These fringe benefits include the costs of employees' group health insurance, pensions, unemployment compensation and other costs necessary to support the workforce. As directed by Massachusetts General Laws, these costs are assessed to other funds based on payroll costs, net of credits for direct payments. Since fringe benefit costs are not separately appropriated or otherwise provided for in these funds, the required assessment creates an unfavorable budget variance in the budgeted funds. The employees' group health insurance and worker's compensation activity is accounted for in the governmental funds. The Commonwealth has elected not to present its cost allocation and recovery separately in the Statement of Activities.

K. School Construction Grants and Contract Assistance Payable

The Commonwealth, through legislation, is committed to reimburse certain cities, towns and regional school districts for a portion of their debt service costs for school construction and renovation. This amount is recorded as long-term

liability in the statement of net assets. The amount to be paid during the next fiscal year is reported as current. For the governmental fund statements, the amounts expected to be liquidated with available financial resources are reported as expenditures and fund liabilities. The liability for school construction grants payable is the present value of the cash flows due to municipalities for the life of the program for existing commitments, discounted at the incremental borrowing rate of the Commonwealth, approximated by the Treasurer and Receiver-General for the fiscal year. During fiscal 2002, the discount rate was 4%.

The Commonwealth recognizes contract assistance due to MCCA, R3N, MWPAT and MassDevelopment on the statement of net assets. These liabilities equate to portions or the whole of certain debt service of these entities. In addition, a payable was declared to the MTA as a cash flow reimbursement for the operations and maintenance of the Central Artery / Tunnel Project.

L. *Compensated Absences*

Compensated absences are recorded as a long-term liability in the statement of net assets. Amounts to be paid during the next fiscal year are reported as current. For the governmental fund statements for governmental funds vested or accumulated vacation and sick leave expected to be liquidated with expendable available financial resources are reported as expenditures and fund liabilities.

Employees are granted vacation and sick leave in varying amounts based on collective bargaining agreements and state laws. Upon retirement, termination or death, certain employees are compensated for unused vacation and sick leave (subject to certain limitations) at their current rate of pay.

In the University and College funds and the discretely presented component units, employees' accumulated vacation and sick leave are recorded as an expense and liability as the benefits accrue.

M. *Lottery Revenue and Prizes*

Ticket revenues and prizes awarded by the Massachusetts Lottery Commission are recognized as drawings are held. For certain prizes payable in installments, the Commonwealth purchases annuities and principal-only and interest-only treasury strips in the Commonwealth's name, which are recorded as annuity contracts and prizes payable in the Agency Funds. Though the annuities are in the Commonwealth's name, they are solely for the benefit of the prizewinner. The Commonwealth retains the risk related to such annuities.

N. *Risk Financing*

The Commonwealth does not insure for employees workers' compensation, casualty, theft, tort claims and other losses. Such losses, including estimates of amounts incurred but not reported, are included as accrued liabilities in the accompanying financial statements when the loss is incurred. For employee's workers' compensation, the Commonwealth assumes the full risk of claims filed under a program managed by the Human Resources Division. For personal injury or property damages, Massachusetts General Laws limit the risk assumed by the Commonwealth to \$100,000 per occurrence, in most circumstances. The Group Insurance Commission administers health care and other insurance for the Commonwealth's employees and retirees.

O. *Net Assets*

The Commonwealth reports net assets as reserved where legally segregated for a specific future use. Otherwise, these balances are considered unrestricted.

Net Assets have been restricted as follows:

"Restricted for capital projects" – identifies amounts reserved for capital projects.

“Restricted for unemployment benefits” – identifies amounts solely for payment of unemployment compensation.

“Restricted for retirement of indebtedness” – identifies amounts held by fiscal agents to fund future debt service obligations pertaining to Special Obligation Revenue Bonds authorized under Section 20 of Chapter 29 of the Massachusetts General Laws and Chapter 33, Acts of 1991. It also includes amounts held for Grant Anticipation Notes authorized by Chapter 11 of the Acts of 1997 and Chapter 121 of the Acts of 1998.

“Restricted for central artery workers’ compensation and general liability” – identifies amounts held to pay future workers’ compensation and general liability claims through the Central Artery / Tunnel project’s owner controlled insurance program.

“Restricted for other purposes” – identifies amounts held for various externally imposed restrictions either by creditors, grantors or laws and regulations of other governments. It also includes various restrictions put forth by the Commonwealth through constitutional or enabling statutes. Included in this restriction are reserves for stabilization and prior appropriations continued.

P. *Reclassifications and Restatement*

During fiscal 2002, the Commonwealth implemented the following new accounting standards issued by the GASB:

Statement No. 34 Basic Financial Statements – and Management’s Discussion and Analysis – For State and Local Governments (GASB 34). GASB 34 as amended by Statement No. 37, Basic Financial Statements – and Management’s Discussion and Analysis – Omnibus establishes new financial reporting standards for state and local governments. The requirements of this statement result in a significant change in the financial reporting model used by governments, including statement formats and changes in fund types and account groups. In addition to the traditional fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statements were required.

Statement No. 35 Basic Financial Statements – and Management’s Discussion and Analysis – For Public Colleges and Universities (GASB 35). GASB 35 establishes financial reporting standards for public colleges and universities within the guidelines of GASB 34 and 37. The institutions of higher education in the Commonwealth, reported as business-type activities, adopted the requirements of GASB 35. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statements were required.

Statement No. 38 Certain Financial Note Disclosures (GASB 38). GASB 38 amends certain note disclosures and adds additional note disclosure requirements related to GASB 34, 35 and 37.

In addition, during fiscal 2002, certain assets held by an insurance company on behalf of the owner controlled insurance program (OCIP) for the payment of general liability claims were included in the financial statements. The OCIP is reported within the other governmental funds. The beginning fund balance of the other governmental funds has been restated to reflect these assets, previously unrecorded receivable balances identified as the result of an audit of the workers’ compensation and general liability program, and an adjustment to incurred but not yet reported claims (IBNR).

As a result of these changes, balances previously reported for OCIP have been restated as follows (amounts in thousands):

Net assets (retained earnings) as audited, June 30, 2001.....	\$	147,236
Change in cash and investments		56,283
Change in receivables		20,365
Increase in incurred but not yet reported claims and judgements - reduction in net assets.....		(9,597)
Restated net assets as of June 30, 2001	\$	<u>214,287</u>

Due to changes in the reporting of certain assets in the OCIP, as previously discussed, and the implementation of Statements 34, 35, and 37, the following amounts have been reclassified and beginning balances have been restated (amounts in thousands):

<i>Governmental Funds and Activities</i>	June 30, 2001 As Previously Reported	Fund Reclassifications	Accounting Adjustments	June 30, 2001 As Restated
Major governmental funds:				
General fund	\$ 2,730,216	\$ -	\$ -	\$ 2,730,216
Previously reported as special revenue funds:				
Local aid fund	-	127,098	-	127,098
Lotteries fund	-	(13,017)	-	(13,017)
Previously reported as debt service fund:				
Debt service fund	-	-	-	-
Previously reported as capital project fund fund:				
Highway capital projects fund	-	(849,605)	-	(849,605)
	<u>-</u>	<u>1,637,373</u>	<u>-</u>	<u>1,637,373</u>
Total major governmental funds	<u>2,730,216</u>	<u>901,849</u>	<u>-</u>	<u>3,632,065</u>
Nonmajor governmental funds:				
Previously reported as special revenue funds:				
Federal grants fund	(6,245)	-	-	(6,245)
Highway fund	(265,289)	-	-	(265,289)
Local aid fund	127,098	(127,098)	-	-
Environmental funds	(53,914)	-	-	(53,914)
Lotteries fund	(13,017)	13,017	-	-
Universal health care fund	153,679	-	-	153,679
Other minor funds	<u>1,086,496</u>	<u>1,586</u>	<u>-</u>	<u>1,088,082</u>
Nonmajor governmental funds	<u>1,028,808</u>	<u>(112,495)</u>	<u>-</u>	<u>916,313</u>
Capital project funds:				
General capital projects fund	(107,117)	-	-	(107,117)
Capital investment trust fund	3,851	-	-	3,851
Convention and exhibition center fund	(154,832)	-	-	(154,832)
Capital improvements and investment trust fund	108,133	-	-	108,133
Capital expenditure reserve fund	(143,427)	-	-	(143,427)
Highway capital projects fund	(849,605)	849,605	-	-
Federal highway construction fund	(280)	-	-	(280)
Central artery statewide roads and bridges fund	<u>1,637,373</u>	<u>(1,637,373)</u>	<u>-</u>	<u>-</u>
Capital needs investment trust fund	16,017	-	-	16,017
Government land bank fund	(6,300)	-	-	(6,300)
Intercity bus capital fund	(3,531)	-	-	(3,531)
Local aid capital projects fund	(3,823)	-	-	(3,823)
Owner controlled insurance program *	<u>-</u>	<u>214,287</u>	<u>38,934</u>	<u>253,221</u>
Total capital projects fund balances	<u>496,459</u>	<u>(573,481)</u>	<u>38,934</u>	<u>(38,088)</u>

* As restated

(Continued)

(continued)

	June 30, 2001 As Previously Reported	Fund Reclassifications	Accounting Adjustments	June 30, 2001 As Restated
Proprietary Funds and Business - Type Activities				
Major funds:				
Previously reported as fiduciary funds and expendable trusts:				
Unemployment compensation fund	-	2,321,611	-	2,321,611
Previously reported as university and college type:				
Higher education systems	-	3,066,949	-	3,066,949
Total major proprietary funds	-	5,388,560	-	5,388,560
Nonmajor funds:				
Internal service funds	(100,060)	100,060	-	-
Subtotal Proprietary funds and business - type activities	(100,060)	5,488,620	-	5,388,560
Adoption of GASB 34, 35 and 37:				
Capital assets, net of accumulated depreciation	-	-	(1,605,999)	(1,605,999)
Other accounting changes	-	-	16,592	16,592
Adoption of GASB 34, 35 and 37	-	-	(1,589,407)	(1,589,407)
Total Proprietary funds and business - type activities	(100,060)	5,488,620	(1,589,407)	3,799,153
Total Primary Government	\$ 9,885,759	\$ 270,472	\$ (10,768,229)	\$ (611,998)
Other adjustments:				
Fiduciary funds:				
Pension trust funds	29,503,347	-	-	29,503,347
External investment trust funds	2,890,323	-	-	2,890,323
Private purpose funds - non - expendable trust	5,834	-	-	5,834
Total fiduciary funds	32,399,504	-	-	32,399,504
University and college type:				
Higher education systems	3,066,949	(3,066,949)	-	-
Total university and college type	3,066,949	(3,066,949)	-	-
Account groups:				
General fixed assets	4,010,561	-	(4,010,561)	-
Total account groups	4,010,561	-	(4,010,561)	-
Total other adjustments	\$ 39,477,014	\$ (3,066,949)	\$ (4,010,561)	\$ 32,399,504

(Concluded)

2. BUDGETARY CONTROL

State finance law requires that a balanced budget be approved by the Governor and the Legislature. The Governor presents an annual budget to the Legislature which includes estimates of revenues and other financing sources and recommended expenditures and other financing uses. The Legislature, which has full authority to amend the budget, adopts a budget for expenditure by appropriating monies at the individual appropriation account level in an annual appropriations act.

Before signing the appropriations act, the Governor may veto or reduce any specific item, subject to legislative override. Further changes to the budget established in the annual appropriations act may be made via supplemental appropriations acts or other legislative acts. These must also be signed by the Governor and are subject to the line item veto.

In addition, Massachusetts General Laws authorize the Secretary of Administration and Finance, with the approval of the Governor, upon determination that available revenues will be insufficient to meet authorized expenditures, to withhold allotments of appropriated funds which effectively reduce the account's expenditure budget.

The majority of the Commonwealth's appropriations are non-continuing accounts which lapse at the end of each fiscal year. Others are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for spending in the current fiscal year. In addition, the Legislature may direct that certain revenues be retained and made available for spending within an appropriation. Fringe benefits and other costs which are mandated by state finance law are not itemized in the appropriation process and are not separately budgeted.

The original FY02 appropriations act, Chapter 177, Acts of 2001, authorized \$21,238,263,000 in direct appropriations. In addition, the act contained \$975,257,000 in authorizations to retain and expend certain non-tax revenues of which \$970,218,000 were estimated to be collected and expended. The Act and supplemental appropriations also included \$135,159,000 in interagency chargebacks. Chapter 177 included estimates of \$14,929,954,500 in tax revenues and \$6,860,600,000 in non-tax revenues. With these revenues (exclusive of chargebacks) projected to total \$21,790,554,500 and with unreserved balances of \$369,500,000 (exclusive of the Mosquito and Greenhead Fly Control Fund which became a non-budgeted fund in FY02) carried forward from the FY01, the budget as presented in this original appropriation act was considered to be in balance.

During FY02, the Legislature also passed and the Governor signed, with some modification through veto, Chapters 183 - 199, Chapters 203 and 220 of the Acts of 2001 and Chapter 118 of the Acts of 2002, which included numerous supplemental budgetary appropriations. These supplements added \$512,919,000 of indirect appropriations and \$11,857,000 in retained revenue authorizations.

Subsequent to June 30, 2002, the Legislature passed and the Governor signed Chapters 300 of the Acts of 2002, which included \$45,799,000 in additional supplemental appropriations and \$3,116,500 in additional retained revenue authorizations. The cumulative FY02 appropriations, retained revenues and interagency chargebacks totals \$23,068,792,000. Appropriations continued from FY01 totaled \$290,029,000 and certain interfund transfers directed by statute totaled \$1,874,431,000.

Because revenue budgets are not updated subsequent to the original appropriation act, the comparison of the initial revenue budget to the subsequent, and often modified, expenditure budget can be misleading. Also, these financial statements portray fund accounting with gross inflows and outflows, thus creating a discrepancy to separately published budget documents. In conducting the budget process, the Commonwealth excludes those interfund transactions that by their nature have no impact on the combined fund balance of the budgeted funds.

Expenditures may not exceed the level of spending authorized for an appropriation account. The Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated.

During FY02, the Commonwealth experienced a significant downturn in the collection of certain tax revenues. The revenue estimates, under the provisions of section 5D of Chapter 29 of General Laws, were determined to be insufficient to meet all of the expenditures authorized to be made for FY02. Therefore, in accordance with section 9C of said Chapter 29, the Secretary for Administration and Finance notified the Governor and the House and Senate Committees on Ways and Means of the amount of the probable deficiency of revenue. In accordance with powers granted to the Governor under said section 9C, the Governor reduced allotments under section 9B of said Chapter 29. The amount of this reduction was \$120,257,000.

3. DEPOSITS AND INVESTMENTS

Cash and Short-term Investments –The Commonwealth maintains a cash and short-term investment pool, which is utilized by the Governmental and Fiduciary Fund types.

Primary Government -

As of June 30, 2002, the carrying amount of the Primary Government's total cash and cash equivalents was \$2,275,651,000 and the corresponding bank balance was \$1,947,385,000. Bank deposits in the amount of \$5,548,000 were insured by the Federal Deposit Insurance Corporation, \$119,942,000 were collateralized in the name of the Commonwealth and are held by various financial institutions. Deposits of \$1,821,895,000 were uninsured and uncollateralized.

Component Units -

As of June 30, 2002, the carrying amount of the discretely presented component unit's total cash and cash equivalents was \$1,630,235,000 and the corresponding bank balances were \$1,251,504,000. Bank deposits of \$148,442,000 were insured by the Federal Deposit Insurance Corporation, \$56,893,000 were collateralized in the name of the respective component units, and \$1,046,169,000 were uninsured and uncollateralized.

Investments – The investments are reported at fair value in the financial statements. The deposits and investments of the Component Units and the University and College Funds and the investments of the Pension Trust Funds are held separately from those of other Commonwealth funds, with the exception of their investments in MMDT. Statutes authorize the Primary Government to invest in obligations of the U.S. Treasury, authorized bonds of all states, bankers' acceptances, certificates of deposit, commercial paper rated within the three highest classifications established by Standard & Poor's Corporation and Moody's Commercial Paper Record and repurchase agreements secured by any of these obligations. The Pension Trust Funds are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments. In the following table, these alternative investments, venture capital and futures pools are classified as other investments.

Short-term investments and investments are classified as to collateral risk into the following three categories:

Category 1: Insured or registered, or securities held by the Commonwealth or its agent in the Commonwealth's name.

Category 2: Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Commonwealth's name.

Category 3: Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Commonwealth's name.

Primary Government – Investments of the Government at June 30, 2002, were as follows (amounts in thousands):

	Category 1	Category 2	Category 3	Total
<u>Investment</u>				
Repurchase agreements.....	\$ 506,354	\$ 6,449	\$ 464	\$ 513,267
U.S. Treasury obligations.....	2,333,101	7,013	-	2,340,114
Commercial paper.....	3,969,251	-	-	3,969,251
Government obligations.....	3,051,986	23,463	7,361	3,082,810
Equity securities.....	15,350,070	791	53,439	15,404,300
Fixed income securities.....	2,243,205	237	652,259	2,895,701
Asset backed investments.....	110	-	26	136
Notes.....	301,565	-	-	301,565
Other.....	453	12,816	1,648	14,917
	<u>\$ 27,756,095</u>	<u>\$ 50,769</u>	<u>\$ 715,197</u>	28,522,061
Mutual fund investments.....				60,511
Annuity contracts.....				1,418,745
Real estate.....				1,861,249
Assets held in trust.....				2,444,691
Deposits with U. S. Treasury.....				1,427,582
Negotiable Certificates of Deposits.....				176,724
Other.....				3,199,884
Total.....				<u>\$ 39,111,447</u>

Financial Investments with Off-Balance Sheet Risk – Certain investments of the Commonwealth may involve a degree of risk not accounted for on the respective financial statements. A description of such “off-balance sheet risks” is as follows.

i) Forward Currency Contracts – The Pension Trust Funds enter into forward currency contracts to hedge the exposure to changes in foreign currency exchange rates on foreign portfolio holdings. The market value of the contract will fluctuate with changes in currency exchange rates.

The contract is marked-to-market daily and the change in market value is recorded by the fund as an unrealized gain or loss by the Pension Trust Fund.

When the contract is closed, the Pension Trust Funds record a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. The maximum potential loss from such contract is the aggregate face value in U.S. dollars at the time the contract was opened.

ii) Futures Contracts – The Pension Trust Funds may purchase and sell financial futures contracts to hedge against changes in the values of securities the fund owes or expects to purchase. Upon entering such contracts, they must pledge to the broker an amount of cash or securities equal to the minimum “initial margin” requirements of the futures.

The potential risk is that the change in the value of futures contracts primarily corresponds with the value of underlying instruments, which may not correspond to the change in value of the hedged instruments. In addition, there is a risk that PRIT may not be able to close out its futures positions due to a nonliquid secondary market. Risks may arise from the potential inability of a counterparty to meet the terms of a contract and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar. The Pension Trust Funds may also invest in financial futures contracts for nonhedging purposes.

Payments are made or received by the Pension Trust Funds each day, depending on the daily fluctuations in the value of the underlying security, and are recorded as unrealized gains or losses. When the contracts are closed, the Pension Trust Funds recognize a gain or loss.

iii) Forward Purchase Agreement – During fiscal 2002, the Commonwealth entered into a forward purchase agreement with two investment providers to receive investment earnings on grant draws for the payment of the Commonwealth’s Grant Anticipation Notes’ (GANs) principal and interest for the period from June 19, 2002 to July 15, 2014 for note payments approximately six to eleven months after these grant draws. The value of this contract to the Commonwealth was satisfied at closing with a payment to the Commonwealth of \$76,435,000. Such amounts are presented as an inflow to the Highway Fund and revenue to the Commonwealth. The agreements may only be terminated in the event of a defeasance or refunding of the GANs by the Commonwealth. Should termination occur, the Commonwealth may be liable for a termination amount to be agreed upon between the Commonwealth and the providers at the termination date.

iv) Options – PRIT is also engaged in selling or “writing” options. The Pension Trust Funds, as writers of options, may have no control over whether the underlying securities may be sold (call) or purchased (put) and, as a result, bear the market risk of an unfavorable change in the price of the security underlying the written option. As of June 30, 2002, there were no material options outstanding.

Component Units – Investments of the discretely presented Component Units at June 30, 2002 are as follows (amounts in thousands):

	Category 1	Category 2	Category 3	Total
<u>Investment</u>				
Repurchase agreements.....	\$ 14,052	\$ 196,969	\$ 5,879	\$ 216,900
U.S. Treasury obligations.....	76,807	-	-	76,807
Commercial paper.....	110,995	-	-	110,995
Government obligations.....	597,511	150	32,194	629,855
Equity securities.....	2,182	-	1,044	3,226
Fixed income securities.....	44,148	-	516	44,664
Notes.....	8,433	-	5,837	14,270
Other.....	101	-	3,885	3,986
	<u>\$ 854,229</u>	<u>\$ 197,119</u>	<u>\$ 49,355</u>	1,100,703
Mutual Fund Investments.....				2,799
Assets held in trust.....				6,398
Guaranteed investment contracts.....				987,684
Negotiable Certificate of deposits.....				11,779
Total.....				<u>\$ 2,109,363</u>

4. RECEIVABLES

Taxes, federal reimbursements, loans and other receivables are presented in the statement of net assets as follows (amounts in thousands):

<i>Primary Government</i>	<u>Taxes Receivable</u>	<u>Federal Grants and Reimbursements</u>	<u>Loans</u>	<u>Other Receivables</u>	<u>Total</u>
Governmental receivables	\$ 1,854,849	\$ 1,101,583	\$ -	\$ 814,668	\$ 3,771,100
Business-type activity receivables.....	300,046	27,705	59,230	267,544	654,525
Less: allowance for uncollectibles.....	(419,464)	(7,670)	(7,340)	(641,008)	(1,075,482)
Receivables, net of allowance for uncollectibles	1,735,431	1,121,618	51,890	441,204	3,350,143
Less: Current Portion:					
Governmental activities	(1,536,092)	(1,093,913)	-	(240,934)	(2,870,939)
Business-type activities	(199,339)	(27,705)	(36,810)	(150,679)	(414,533)
Noncurrent receivables	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 15,080</u>	<u>\$ 49,592</u>	<u>\$ 64,671</u>

<i>Discretely Presented Component Units</i>	<u>Taxes Receivable</u>	<u>Federal Grants and Reimbursements</u>	<u>Loans</u>	<u>Other Receivables</u>	<u>Total</u>
Massachusetts Bay Transportation Authority	\$ -	\$ 7,708	\$ -	\$ 33,405	\$ 41,113
Massachusetts Turnpike Authority.....	-	-	-	41,738	41,738
Massachusetts Water Pollution Abatement Trust	-	99,442	1,841,334	47,364	1,988,140
Nonmajor Component Units	-	17,377	255,112	45,299	317,788
Less: allowance for uncollectibles.....	-	-	(8,799)	(1,470)	(10,269)
Receivables, net of allowance for uncollectibles	\$ -	\$ 124,527	\$ 2,087,647	\$ 166,336	\$ 2,378,510
Less: Current Portion	-	(120,793)	(160,571)	(129,553)	(410,917)
Noncurrent receivables	<u>\$ -</u>	<u>\$ 3,734</u>	<u>\$ 1,927,076</u>	<u>\$ 36,783</u>	<u>\$ 1,967,593</u>

*On the statement of net assets for component units, the long - term portions of federal grants and reimbursements and other receivables are combined to total \$40,517.

5. RECEIVABLES AND PAYABLES BETWEEN FUNDS AND COMPONENT UNITS

Receivables and payables between funds and component units reflected as due to/from primary government/component units in the combined balance sheet at June 30, 2002 are summarized as follows (amounts in thousands):

Primary Government

Due to / from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
<u>Governmental Funds</u>		
General Fund	Local Aid Fund	\$ 878,172
	Highway Capital Projects Fund	482,610
	Nonmajor Governmental Funds.....	699,861
	Proprietary Funds - University of Massachusetts.....	10,828
Central Artery Statewide Road and Bridge Fund	General Fund	1,097,231
Nonmajor Governmental Funds	General Fund	157,482
Nonmajor Governmental Funds	Nonmajor Governmental Funds	<u>66,998</u>
Total Primary Government		<u>\$ 3,393,182</u>

Component Units

Due to / from the Commonwealth and Component Units:

Massachusetts Turnpike Authority	General Fund	\$ 16,393 (1)
Massachusetts Water Pollution Abatement Trust	Local Aid Fund	13,115
	Nonmajor Governmental Funds	20,650
Massachusetts Bay Transportation Authority	Nonmajor Governmental Funds	118,133 (2)
Nonmajor Component Units	General Fund	62,625 (3)
	Local Aid Fund	28,994
	Nonmajor Governmental Funds	193,889 (4)
	Accrued Interest Payable	<u>36,708</u>
Total Component Units		<u>\$ 490,507</u>

- (1) - Includes a timing difference from the Massachusetts Turnpike Authority due to the Authority's fiscal year ending on December 31, 2001.
- (2) - Includes a difference of accrual for the Massachusetts Bay Transportation Authority for taxes receivable.
- (3) - Includes long term contract assistance payable to the Massachusetts Convention Center Authority, a nonmajor Component Unit.
- (4) - Includes long term contract assistance payable to the Route 3 North Transportation Improvements Association, included as a nonmajor Component Unit.

The Commonwealth is currently engaged in the most expensive public construction project in the history of the United States, the Central Artery / Tunnel Project (CA/T or Project). The project will depress the Central Artery (Interstate 93) through downtown Boston and connect the Massachusetts Turnpike (Interstate 90) through a tunnel under Boston Harbor directly to Logan International Airport. In addition to Commonwealth debt and funds from the Federal Government, the MTA, a component unit and MassPort, a related organization, have contributed to the costs of construction. Once completed the assets of the project will be transferred to these entities for operations and maintenance.

All contributions to the Central Artery / Tunnel Project from component units are reflected as additions to construction in process on the various component units' financial statements, pursuant to Massachusetts General Laws, Chapter 81A. The Commonwealth reflects these payments as transfers from component units.

As part of the Commonwealth's implementation of GASB 34, the Commonwealth has recorded the Commonwealth's construction cost to date for the Central Artery / Tunnel Project, net of amounts transferred to the MTA and Massport. This amount is reflected as "Construction in Process – Central Artery / Tunnel Project". This construction in process amount is offset by two corresponding liabilities: "Due to Component Units – Central Artery / Tunnel Project" for the MTA's portion and "Due to Other – Central Artery / Tunnel Project" for Massport's portion. As portions of the project are completed and transferred to either the Turnpike Authority or Massport in accordance with Massachusetts General Laws, Chapter 81A (MGL 81A) (upon agreement of the various engineers and the Authorities' Boards of Directors), these amounts will be reduced for the value of the assets transferred.

The MTA presents its audited financial statements under GASB 34 on a calendar year basis for the year ended December 31, 2001. For fiscal 2002, the Commonwealth had the following payable to Component Units – Central Artery / Tunnel Project activity (amounts in thousands):

Total Project budget as of June 30, 2002	<u>\$ 14,625,000</u>
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I. Determination of MTA amounts:

Cumulative Authorized Project Invoices as of June 30, 2002	\$ 11,675,980
Less: Amounts to be transferred to Massport as of December 31, 2001	(354,747)
Less: Amounts transferred previous to December 31, 2001 to Massport	(10,252)
Less: Amounts transferred previous to December 31, 2001 to the MTA	<u>(1,999,589)</u>

Subtotal - Due to Component Units - Central Artery / Tunnel Project as of June 30, 2002	9,311,393
Less: Construction Expenses January 1 to June 30, 2002	(724,670)
Amounts recognized as contributed by the MTA as of December 31, 2001	<u>(1,555,000)</u>

Amounts not recognized as contributed to the MTA in their financial statements as of December 31, 2001	<u>\$ 7,031,723</u>
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II. Determination of Massport Amounts:

Massport's Portion of the Central Artery / Tunnel Project as determined under Massachusetts General Laws Chapter 81A	\$ 365,000
Less: Amounts transferred to Massport as of June 30, 2002	<u>(10,253)</u>

Due to Related Organizations - Central Artery / Tunnel Project as of June 30, 2002	<u>\$ 354,747</u>
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6. FIXED ASSETS

Capital asset activities for the fiscal year ended June 30, 2002 are as follows (amounts in thousands):

<i>Primary Government Governmental Activities</i>	July 1, 2001 Beginning Balance	Increases	Decreases	June 30, 2002 Ending Balance
Capital assets not being depreciated:				
Land	\$ 595,295	\$ 48,797	\$ 175	\$ 643,917
Construction in process - non - Central Artery / Tunnel project	30,478	455,190	19,871	465,797
Construction in process - Central Artery / Tunnel project	8,293,818	1,372,322	-	9,666,140
Total capital assets not being depreciated	8,919,591	1,876,309	20,046	10,775,854
Capital assets being depreciated:				
Buildings	2,708,408	746,702	-	3,455,110
Machinery and equipment	658,038	37,465	19,461	676,042
Infrastructure.....	10,560,317	173,796	-	10,734,113
Total capital assets being depreciated	13,926,763	957,963	19,461	14,865,265
Less, accumulated depreciation:				
Buildings	2,060,370	68,260	-	2,128,630
Machinery and equipment	505,997	32,218	9,068	529,147
Infrastructure.....	3,242,175	514,317	-	3,756,492
Total accumulated depreciation	5,808,542	614,795	9,068	6,414,269
Total capital assets being depreciated, net	8,118,221	343,168	10,393	8,450,996
Governmental activity capital assets, net	<u>\$ 17,037,812</u>	<u>\$ 2,219,477</u>	<u>\$ 30,439</u>	<u>\$ 19,226,850</u>
<i>Business - Type Activities</i>				
Capital assets not being depreciated:				
Land	\$ 63,814	\$ 4,621	\$ 250	\$ 68,185
Construction in process	130,423	132,603	147,286	115,740
Historical treasures	536	17	-	553
Total capital assets not being depreciated	194,773	137,240	147,536	184,477
Capital assets being depreciated:				
Buildings	1,923,684	193,836	2,446	2,115,075
Machinery and equipment	538,157	121,134	37,644	621,648
Library collections, not including historical treasures	127,798	7,782	7,053	128,527
Total capital assets being depreciated	2,589,640	322,753	47,143	2,865,250
Less, accumulated depreciation:				
Buildings	1,135,289	79,169	21,536	1,192,922
Machinery and Equipment	328,375	35,955	7,713	356,618
Infrastructure.....	12,388	2,132	673	13,847
Total accumulated depreciation	1,476,053	117,256	29,922	1,563,388
Total capital assets being depreciated, net	1,113,587	205,497	17,222	1,301,863
Business - type activity capital assets, net	<u>\$ 1,308,360</u>	<u>\$ 342,737</u>	<u>\$ 164,758</u>	<u>\$ 1,486,341</u>
Total Primary Government capital assets, net	<u>\$ 18,346,172</u>	<u>\$ 2,562,214</u>	<u>\$ 195,197</u>	<u>\$ 20,713,191</u>

Depreciation expense is not charged to particular functions of the primary government. It is charged in the aggregate.

Discretely Presented Component Units – Fixed assets consist of the following at June 30, 2002 (amounts in thousands):

<i>Discretely Presented Component Units</i>	July 1, 2001 Beginning Balance	Increases	Decreases	June 30, 2002 Ending Balance
Capital assets not being depreciated:				
Land	\$ 411,472	\$ 9,292	\$ 32	\$ 420,732
Construction in process	1,745,735	673,500	307,364	2,111,871
Total capital assets not being depreciated	2,157,207	682,792	307,396	2,532,603
Capital assets being depreciated:				
Buildings	7,028,656	246,009	1,546	7,273,119
Machinery and equipment	1,952,373	109,357	7,834	2,053,896
Infrastructure	1,386,266	15,158	-	1,401,424
Total capital assets being depreciated	10,367,295	370,524	9,380	10,728,439
Less, accumulated depreciation	3,344,571	303,848	9,196	3,639,223
Total capital assets being depreciated, net	7,022,724	66,676	184	7,089,216
Discretely Presented Component Unit capital assets, net	\$ 9,179,931	\$ 749,468	\$ 307,580	\$ 9,621,819

7. SHORT-TERM FINANCING AND CREDIT AGREEMENTS

Primary Government -

Massachusetts General Laws authorizes the Treasurer to issue temporary notes in anticipation of revenue or bond financing. When this short-term debt does not meet long-term financing criteria, it is classified as a fund liability. Short-term debt may be issued on either a stand-alone basis or through a commercial paper program maintained by the Commonwealth.

The following table summarizes short-term financing and credit activity for fiscal 2002 (amounts in thousands):

<i>Primary Government</i>	July 1, 2001 Beginning Balance	Issued / Drawn	Redeemed / Retired	June 30, 2002 Ending Balance	Credit Limit
Commercial paper (RANs)	\$ -	\$ 683,000	\$ 683,000	\$ -	\$ -
Letters of credit facilities	-	-	-	-	200,000
Lines of credit facilities	-	-	-	-	800,000
Bond anticipation notes *	400,000	830,000	700,000	530,000	-
Total Primary Government	\$ 400,000	\$ 1,513,000	\$ 1,383,000	\$ 530,000	\$ 1,000,000
<i>Discretely Presented Component Units</i>	July 1, 2001 Beginning Balance	Increases	Decreases	June 30, 2002 Ending Balance	Credit Limit
Nonmajor component units:					
Revolving lines of credit	\$ -	\$ 350	\$ -	\$ 350	\$ 1,000
Revenue anticipation notes	87,513	64,042	88,233	63,322	-
Discretely Presented Component Units	\$ 87,513	\$ 64,392	\$ 88,233	\$ 63,672	\$ 1,000

Amounts are included as part of current bonds, notes payable and other obligations within the Statement of Net Assets.

* The June 30, 2002 balance includes General Obligation Notes of \$350,000,000 and General Obligation BANs for CA/T project for \$180,000,000.

General Fund –The balance of revenue anticipation notes (RANs) outstanding may fluctuate during a fiscal year, but must be reduced to zero at June 30. During FY02, the Commonwealth issued RANs through its commercial paper program on a periodic basis to meet cash flow needs. Up to \$683,000,000 of RANs were issued during the year. All RANs were retired before the end of May, 2002.

Capital Projects Funds – The Commonwealth may issue bond anticipation notes (BANs) to temporarily finance its capital projects. BANs may be issued either on a stand-alone basis or through the Commonwealth's commercial paper program.

During FY02 the Commonwealth periodically issued BANs through the commercial paper program, beginning in August 2001. BANs were rolled over and paid down at various times during the fiscal year. No more than \$300,000,000 of BANs were outstanding under the commercial paper program at any time and all BANs were retired before the end of February, 2002.

During FY02, the Commonwealth also sold BANs on a stand-alone basis. On September 5, 2001, \$350,000,000 of General Obligation BANs were issued to finance costs associated with the development of Convention Centers in Boston, Worcester and Springfield, and to retire a portion of BANs issued prior to the sale. The BANs mature on September 1, 2003.

On March 28, 2002, \$180,000,000 of General Obligation BANs were issued. The BANs, issued to finance costs of the Central Artery / Tunnel Project, in advance of receiving certain contributions from the Massachusetts Port Authority (Massport), mature on April 25, 2003. The amount remaining to be paid by Massport totals approximately \$205 million, payable in three installments of approximately \$105 million, \$50 million and \$50 million on December 31, 2002, 2003 and 2004, respectively. Due to the events of September 11, 2001, Massport has experienced significant reductions in revenues and operations, as well as increases in certain expenses. The duration of these circumstances cannot be known. Massport has advised the Commonwealth that it does not expect to issue bonds to meet its December 2002 obligation until the summer of 2003. The Commonwealth has agreed to reschedule the payment due from Massport. The FY03 general appropriation act has provisions for the Commonwealth to charge Massport interest costs related to this transaction due to the delay in payment.

Letter-of-Credit Agreements – During FY02, the Commonwealth maintained a letter-of-credit agreement with a bank in order to provide credit and liquidity support for its commercial paper program. The letter of credit was available to secure up to \$200,000,000 of Commonwealth commercial paper plus interest thereon. Advances were available, subject to certain limitations and bearing interest at the bank rate as defined, in anticipation of revenue or bond proceeds repayable by the following June 30, subject to extension in certain circumstances at the Commonwealth's option. No such advances were drawn during the fiscal year ended June 30, 2002. The existing letter of credit facility expires on December 28, 2003. The cost of the facility is approximately 0.15% on both unutilized and utilized amounts.

Line-of-Credit Agreements – During FY02, the Commonwealth maintained line-of-credit facilities to provide liquidity support for commercial paper notes. The total of such facilities was increased from \$400,000,000 to \$800,000,000

during the course of the fiscal year. The Commonwealth has a total of four line-of-credit facilities to provide such liquidity support for each in the amount of \$200,000,000. No such advances were drawn during the fiscal year ended June 30, 2002. These facilities expire in September and December of 2004, and March and September of 2005 respectively. The cost of these facilities ranges from 0.125% to 0.17%.

Discretely Presented Component Units -

The RTAs had \$63,672,000 short-term notes payable outstanding at June 30, 2002. All the notes mature during fiscal year 2002 and have interest rates ranging from 2.25% to 4.95%.

Subsequent to June 30, 2002, the RTAs rolled over \$37,083,000 of revenue anticipation notes with interest rates ranging from 1.63% to 2.75% due in fiscal year 2003.

8. LONG-TERM OBLIGATIONS

Under the Constitution of the Commonwealth of Massachusetts, the Commonwealth may borrow money (a) for defense, (b) in anticipation of receipts from taxes or other sources, any such loan to be paid out of the revenue of the year in which the loan is made, or (c) by a two-thirds vote of the members of each house of the Legislature present and voting thereon. The Constitution further provides that borrowed money shall not be expended for any other purpose than that for which it was borrowed or for the reduction or discharge of the principal of the loan. In addition, the Commonwealth may give, loan or pledge its credit by a two-thirds vote of the members of each house of the Legislature present and voting thereon, but such credit may not in any manner be given or loaned to or in aid of any individual, or of any private association, or of any corporation which is privately owned or managed.

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, including bonds and notes issued by it and all claims with respect thereto. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for the payment of principal or interest on bonds and notes of the Commonwealth may also be subject to the provisions of federal or Commonwealth statutes, if any, enacted to extend the time for payment or impose other constraints upon enforcement.

As of June 30, 2002, the Commonwealth had three types of long-term debt outstanding: general obligation bonds, special obligation bonds and grant anticipation notes.

A. General Obligation Bonds

General Obligation bonds are authorized and issued primarily to provide funds for Commonwealth-owned capital projects and local government improvements. They are backed by the full faith and credit of the Commonwealth and paid from the Governmental Funds, in which debt service principal and interest payments are appropriated. Massachusetts General Laws provide for the allocation of bond proceeds to these authorizations in arrears, as expenditures are made, unless the proceeds are allocated at the time of issuance.

i. College Opportunity Bonds

Some Commonwealth general obligation debt is issued as College Opportunity Bonds (COBs) as authorized by the Massachusetts General Laws. Such bonds

were initially issued in fiscal year 1996, and have been issued in each subsequent fiscal year including fiscal year 2002 when approximately \$5,636,000 of such bonds was issued. Outstanding COBs had maturity dates ranging from 2002 through 2021. COBs have an accreting interest component payable at maturity. The annual accretion rate of each COB's maturity is a variable rate equal to the change in annual Consumer Price Index (CPI) plus 2.0%. Assuming the CPI averages 3.5% during the life of the outstanding COBs the payments due at maturities of the COBs will total approximately \$174,157,000. In addition, COBs pay current interest in the amount of 0.5% per year of the initial amount still outstanding. The full faith and credit of the Commonwealth back these bonds. These bonds are sold to fund the Commonwealth's "U. Plan" which is part of a college savings program administered by the Massachusetts Educational Financing Authority. These bonds are privately placed and are structured to meet the needs of investors in this plan.

ii. County Debt Assumed

Chapter 38 of the Acts of 1997 and Chapter 300 of the Acts of 1998 abolished several Massachusetts counties on various effective dates. As part of these provisions, the Commonwealth assumed the outstanding debt of Middlesex County on July 1, 1997, of Hampden and Worcester Counties on July 1, 1998 and that of Essex County on July 1, 1999 and that of Berkshire County on July 1, 2000. The county debt assumed has become general obligation debt of the Commonwealth. As of June 30, 2002, \$1,115,000 of these obligations remains outstanding.

B. Special Obligation Bonds

The Commonwealth also issues special obligation revenue bonds as authorized by Massachusetts General Laws. Such bonds may be secured by all or a portion of revenues credited to the Highway Fund and are not general obligations of the Commonwealth. At June 30, 2002, the Commonwealth had outstanding \$837,910,000 of such special obligation bonds, secured by a pledge of 6.86 cents of the 21-cent motor fuel excise tax imposed on gasoline.

In June of 2002, the Commonwealth sold \$319,130,000 of special obligation revenue bonds, Series 2002A. Of this amount, \$183,180,000 was issued to refund prior special obligation bonds. The remainder was used to fund capital spending in the Commonwealth. The escrow funded by the refunding bonds and related premium will be used only to secure the principal related to \$190,075,000, exclusive of related call premium in previously issued special obligation bonds maturing on June 1, 2003, 2004, 2006 and 2008. The interest related to these maturities is not secured by this escrow. Rather, it will be paid from the existing stream of motor fuel excise taxes. Interest on a portion of the newly issued refunding bonds will be paid from the proceeds of the escrow until the aforementioned prior bonds are called for redemption. This technique, which is generally referred to as a "crossover refunding," results in economic savings to the Commonwealth similar to a normal refunding, but does not meet the accounting definition of defeasance of debt, in which case the defeased debt and the related escrow accounts would have been removed. Until such time as the escrow is used to repay the principal of the refunded bonds, such amounts will be reported in the Highway Capital Projects Fund.

C. Federal Highway Grant Anticipation Notes (GANS)

The Commonwealth also issues Federal Highway GANS to finance current cash flow for the Central Artery/Tunnel Project in anticipation of future federal reimbursements. Section 9 through 10D of Chapter 11 of the Acts of 1997, as amended by Chapter 121 of the Acts of 1998, authorizes the Commonwealth to sell up to \$1,500,000,000 in GANS. All Federal Highway Construction

reimbursements and reimbursements from the federal highway construction trust funds are pledged to the repayment of the GANS. At June 30, 2002, the Commonwealth has \$1,499,325,000 of GANS outstanding, including accrued interest on capital appreciation bonds with maturity dates ranging from 2005 to 2015. These notes are secured by the pledge of Federal Highway Construction Reimbursements without a general obligation pledge. Under certain limited circumstances, a portion of the revenue from the Commonwealth's motor fuels excise tax may be used to pay debt service on the GANS.

D. Variable Rate Demand Bonds

Included in the long-term debt is \$1,542,600,000 of general obligation variable rate demand bonds (VRDBs) maturing from 2007 through 2030 in varying amounts. The redemption schedule for these bonds is included in the bond redemption schedule contained herein. The interest rate on the VRDBs is determined either weekly or daily based on the activity of the Commonwealth's remarketing agents, and interest is paid monthly. On any reset date holders of the VRDBs can require the Commonwealth (acting through its remarketing and tender agents) to repurchase the bonds (a "put"). The remarketing agent is authorized to use its best efforts to resell any repurchased bonds by adjusting the interest rates offered. The Commonwealth pays an annual fee to the remarketing agents equal to 0.05% of the par amount of the bonds.

Under the provisions of stand-by bond-purchase agreements entered into by the Commonwealth with certain commercial banks, the remarketing and tender agents are entitled to draw amounts sufficient to pay the purchase price of any bonds that cannot be resold. During any such period the Commonwealth is required to pay the bank(s) at an interest rate based on their respective prime lending rates. If the remarketing agent is unable to resell any put bonds within six months of the put date, the stand-by bond-purchase agreements include provisions to convert any such bonds to installment loans payable over an extended period of time, with interest payable at a rate based on the bank(s) prime lending rate(s). The stand-by bond-purchase agreements expire on various dates between September of 2003 and February of 2006. The Commonwealth is required to renew or replace these agreements as long as the VRDBs remain outstanding. The Commonwealth currently pays an annual fee to maintain these agreements, which averages 0.124% of the par amount of the bonds.

E. Interest Rate Swap Agreements

As of June 30, 2002, \$1,267,000,000 of the VRDBs have been issued as general obligation refunding bonds. In connection with the issuance of such refunding bonds, the Commonwealth has entered into interest rate exchange ("swap") agreements with certain counterparties. These agreements require the counterparties to pay the Commonwealth an amount equal to the variable rate payable on the bonds and in return the Commonwealth pays a specified fix rate. Only the net difference in interest payments is exchanged with the counterparty. The Commonwealth continues to pay interest to the bondholders at the applicable variable rates. Through these agreements the Commonwealth has effectively fixed its interest rate payment obligations on the relevant VRDBs at rates ranging from 4.15% to 4.659%, not including the cost of liquidity and remarketing. The Commonwealth will be exposed to a variable rate if the counterparties default or if the swap is terminated. A termination of the swap may also result in the Commonwealth making or receiving a termination payment.

F. Auction Rate Securities

Also included in the long-term debt is \$401,500,000 of general obligation Auction Rate Securities (ARS) maturing in varying amounts from 2020 through 2030. The interest rate payable on the bonds changes weekly as determined

pursuant to specified auction procedures. Interest on the bonds is payable weekly. In the case of a failed auction (i.e., insufficient bids to clear the market) existing buyers may be required to hold their bonds with interest payable at a rate equal to a percentage of an ARS industry index.

G. Outstanding Debt

For financial reporting purposes, long-term debt is carried at its face value, which includes discount and any issuance costs. The outstanding amount represents the total principal to be repaid. For capital appreciation bonds, the outstanding amount represents total principal and accreted interest to be repaid. When short-term debt has been refinanced on a long-term basis, it is reported as outstanding at its face amount.

The amount of long-term debt authorized but unissued is measured in accordance with the statutory basis of accounting. Only the net proceeds (exclusive of discount and costs of issuance) are deducted from the total authorized by the Legislature.

Changes in long-term debt outstanding (including discount and issuance cost) and bonds authorized - unissued for the year ended June 30, 2002 are as follows (amounts in thousands):

<u>Primary Government</u>	<u>Bonds Outstanding</u>	<u>Authorized and Unissued</u>
Balance, July 1, 2001.....	\$ 13,999,454	\$ 9,290,418
General and special obligation bonds:		
Principal, less discount and issuance costs.....	1,486,314	(1,486,314)
Principal issued for sinking fund.....	11,645	-
Net premium and issuance costs.....	(27,687)	-
General and special obligation refunding bonds:		
Principal on refunding bonds	1,360,170	-
Refunded principal, exclusive of cross - over refunding	(1,168,626)	-
Retired discount on refunded bonds	(13,794)	-
Increase in bonds authorized	-	679,554
Bonds retired	(692,341)	-
Balance, June 30, 2002.....	14,955,135	
Less: Current portion of general long - term debt - governmental activities.....	(744,830)	-
Long - term portion of general long - term debt - governmental activities.....	<u>\$ 14,210,305</u>	<u>\$ 8,483,658</u>

Business Type Activities - Colleges and University Debt— Building authorities related to the University of Massachusetts and the state colleges have issued bonds for construction of higher education facilities and equipment. Such bonds are guaranteed by the Commonwealth in an aggregate amount not to exceed \$278,000,000. The bond agreements generally provide that revenues from student fees are pledged as collateral on the bonds and establish bond reserve funds, bond funds, and maintenance reserve funds. The University of Massachusetts and state colleges have also entered into various loan agreements as participants in the Massachusetts Health and Educational Facilities Authority's (MHEFA) ongoing capital asset program to finance construction projects and equipment.

At June 30, 2002, debt service requirements to maturity for principal (including discount, capital appreciation and issuance costs) and interest are as follows for both governmental and business-type activities (amounts in thousands):

Fiscal Year Ended June 30	Governmental Activities		Business - Type Activities	
	General Obligation		Revenue Obligation	
	Principal	Interest	Principal	Interest
2003	\$ 744,830	\$ 739,821	\$ 30,337	\$ 33,877
2004	757,020	700,456	24,582	32,760
2005	822,162	666,861	19,245	31,416
2006	944,752	625,151	20,044	30,494
2007	983,127	577,368	21,326	29,549
2008 - 2012	4,848,232	2,123,589	119,438	130,246
2013 - 2017	3,567,934	997,514	122,896	97,302
2018 - 2022	1,692,925	359,574	118,773	65,670
2023 - 2027	233,399	126,947	82,643	39,570
2028 - 2032	360,754	35,532	106,535	15,998
2023 - 2037	-	-	4,613	477
Total long - term debt	14,955,135	6,952,813	670,432	507,359
Less: Current Portion	(744,830)	(739,821)	(30,337)	(33,877)
Long - term debt	<u>\$ 14,210,305</u>	<u>\$ 6,212,992</u>	<u>\$ 640,095</u>	<u>\$ 473,483</u>

The above schedule assumes the variable rate to be paid at 5%.

H. Bonds Defeased Through Refunding

The Commonwealth issued bonds and notes through both competitive and negotiated sales during fiscal year 2002. The costs for legal counsel and underwriting fees (including estimated amounts related to competitive sales) for bond sales were \$593,000 and \$14,327,000 respectively. In addition, the Commonwealth paid \$186,000 for disclosure counsel services.

As authorized by the Massachusetts General Laws, the Commonwealth advance refunded certain general obligation bonds through the issuance of \$1,176,990,000 of general obligation refunding bonds during fiscal year 2002. Net proceeds totaling approximately \$1,267,751,000 were used to purchase U. S. Government securities which were deposited in irrevocable trusts with an escrow agent to provide for all future debt service payments of the refunded bonds. As a result, the refunded bonds are considered to be defeased, and the liabilities therefore have been removed from long-term obligations. As a result of this refunding, the Commonwealth decreased current year debt service payments and has taken advantage of lower interest rates, and it has decreased its aggregate debt service payments by approximately \$55,013,000 over the next 20 years and will experience an economic gain (the difference between the present values of the debt service payments of the refunded and refunding bonds) of approximately \$47,141,000. At June 30, 2002, approximately \$1,090,330,000 of the bonds refunded remain outstanding and are defeased.

I. Prior Defeasance

In prior years, the Commonwealth defeased certain general and special obligation bonds by purchasing securities (from the proceeds of refunding bonds or from surplus operating funds) and placing them in irrevocable trusts to provide for all future debt service payments on the defeased bonds. Accordingly, the trust account assets and the liabilities for the defeased bonds are not included in the financial statements. At June 30, 2002, approximately \$2,286,432,000 of bonds outstanding from activities in prior fiscal years are considered defeased.

J. Statutory Debt Limit

The Massachusetts General Laws establish limits on the amount of governmental direct debt outstanding. By statutorily limiting the Commonwealth's ability to issue direct debt, this limit provides a control on annual capital spending. The direct debt limit for fiscal year 2002 was approximately \$11,630,307,000. Outstanding governmental debt subject to the limit at June 30, 2002 was approximately \$11,014,062,000. The limit increases 5% per year.

For purposes of determining compliance with the limit, outstanding direct debt is defined to include general obligation bonds and minibonds at the amount of their original net proceeds. It excludes BANs and discount and issuance costs, if any, financed by these bonds. It also excludes special obligation bonds, GANs, refunded bonds, certain refunding bonds, debt issued by counties, and debt issued in conjunction with the MBTA forward funding.

The amounts excluded from the governmental debt limit are as follows (amounts in thousands):

	<u>Debt Outstanding</u>
Balance, June 30, 2002.....	\$ 14,955,135
Less amounts excluded:	
Discount and issuance costs.....	(181,910)
Chapter 5 of the Acts of 1992 refunding.....	(22,043)
Special obligation principal.....	(772,812)
Grant anticipation notes principal.....	(1,500,000)
County debt assumed	(1,115)
Bonds sold for the MBTA forward funding	(625,000)
Bonds sold for the Central Artery / Tunnel Project	<u>(838,193)</u>
Outstanding direct debt subject to statutory debt limit	<u>\$ 11,014,062</u>

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended June 30, 2002, the following changes occurred in liabilities reported as part of the long term liabilities in the statement of net assets (amounts in thousands):

<i>Primary Government Governmental Activities</i>	Interest Rates	Maturity Through	July 1, 2001 Beginning Balance	Increases	Decreases	June 30, 2002 Ending Balance	Due Within One Year
Long - term debt:							
General obligation bonds	0.00 - 8.00%	2031	\$ 11,677,383	\$ 2,612,288	\$ 1,789,260	\$ 12,500,411	\$ 667,956
Special obligation bonds	4.00 - 5.50%	2017	539,242	256,792	23,222	772,812	24,688
Grant anticipation notes	0.00 - 7.00%	2015	1,500,000	-	-	1,500,000	-
Unamortized (Premiums) / Discounts:							
General obligation bonds			280,551	(26,993)	62,085	191,473	52,009
Special obligation bonds			2,953	(11,646)	193	(8,886)	177
Grant anticipation notes			(675)	-	-	(675)	-
Total long - term debt			13,999,454	2,830,441	1,874,760	14,955,135	744,830
Other long - term liabilities			11,825,018	2,630,916	30,733	14,425,201	551,291
Total non - current liabilities			<u>\$ 25,824,472</u>	<u>\$ 5,461,357</u>	<u>\$ 1,905,493</u>	<u>\$ 29,380,336</u>	<u>\$ 1,296,121</u>
<i>Business - Type Activities</i>			July 1, 2001 Beginning Balance	Increases	Decreases	June 30, 2002 Ending Balance	Due Within One Year
Long - term debt:							
Revenue obligation debt	0.0 - 7.5%	2037	\$ 575,148	\$ 107,138	\$ 11,856	\$ 670,430	\$ 30,337
Other long - term liabilities			220,731	180,872	31,550	370,053	157,368
Total non - current liabilities			<u>\$ 795,879</u>	<u>\$ 288,010</u>	<u>\$ 43,406</u>	<u>\$ 1,040,483</u>	<u>\$ 187,705</u>

Discretely Presented Component Units – Bonds and notes outstanding at June 30, 2002 (December 31, 2001 for Massachusetts Turnpike Authority), net of unamortized discount of approximately \$165,203,000 and unamortized loss on refunding of approximately \$143,826,000, are as follows (amounts in thousands):

<i>Discretely Presented Component Units</i>			July 1, 2001 Beginning Balance	Increases	Decreases	June 30, 2002 Ending Balance	Due Within One Year
Major component units:							
MBTA	3.85 - 7.80%	2003-2030	\$ 4,001,237	\$ -	\$ 312,229	\$ 3,689,008	\$ 113,461
MTA	5.05 - 5.65%	2004-2039	2,430,994	-	4,434	2,426,560	12,295
MWPAT	3.00 - 6.375%	2003-2030	1,677,710	322,228	262,899	1,737,039	73,050
Nonmajor component units	1.77 - 9.00%	2003-2034	900,759	596,353	378,306	1,118,806	62,214
Total bonds payable			9,010,700	918,581	957,868	8,971,413	261,020
Compensated absences			24,900	17,096	16,420	25,576	19,370
Total Component Units			<u>\$ 9,035,600</u>	<u>\$ 935,677</u>	<u>\$ 974,288</u>	<u>\$ 8,996,989</u>	<u>\$ 280,390</u>

The amounts below represent the gross face amounts of bonds and notes outstanding and may differ from the amounts included in the combined balance sheet due to treatment of original issue discount in the general-purpose financial statements. Maturities of principal and interest are as follows (amounts in thousands):

Fiscal Year Ended June 30,	Massachusetts Bay Transportation Authority		Massachusetts Turnpike Authority		Massachusetts Water Pollution Abatement Trust		Nonmajor Component Units		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2003.....	\$ 112,321	\$ 210,860	\$ 12,295	\$ 121,697	\$ 73,050	\$ 89,248	\$ 62,184	\$ 41,139	\$ 259,850	\$ 462,944
2004.....	88,535	204,891	13,050	120,973	75,055	85,973	75,522	80,159	252,162	491,996
2005.....	94,315	200,229	39,935	119,066	76,480	82,578	35,223	59,730	245,953	461,603
2006.....	115,165	196,891	19,535	118,054	76,915	79,059	34,911	56,816	246,526	450,820
2007.....	130,795	192,820	19,890	117,009	79,230	79,082	32,861	47,847	262,776	436,758
2008 - 2012.....	779,345	838,467	193,885	559,482	422,185	311,916	125,868	218,241	1,521,283	1,928,106
2013 - 2017.....	794,635	603,078	189,770	515,856	416,470	205,991	167,587	179,914	1,568,462	1,504,839
2018 - 2022.....	807,580	387,023	365,502	564,198	291,905	99,180	167,885	155,306	1,632,872	1,205,707
2023 - 2027.....	671,205	175,775	239,917	497,454	158,565	38,853	161,470	118,184	1,231,157	830,266
2028 - 2032.....	281,275	32,036	310,718	418,555	66,570	6,340	188,458	54,304	847,021	511,235
2033 - 2037.....	-	-	137,945	176,477	-	-	65,125	5,679	203,070	182,156
2038 - 2041.....	-	-	998,641	21,522	-	-	3,555	289	1,002,196	21,811
Total long - term debt*....	3,875,171	3,042,070	2,541,083	3,350,343	1,736,425	1,078,220	1,120,649	1,017,608	9,273,328	8,488,241
Less: Current portion*.....	(112,321)	(210,860)	(12,295)	(121,697)	(73,050)	(89,248)	(62,184)	(41,139)	(259,850)	(462,944)
Long - term debt*.....	\$ 3,762,850	\$ 2,831,210	\$ 2,528,788	\$ 3,228,646	\$ 1,663,375	\$ 988,972	\$ 1,058,465	\$ 976,469	\$ 9,013,478	\$ 8,025,297

* Does not include certificates of participation below.

The MBTA issued certificates of participation (COPs) in the amounts of approximately \$28,565,000 on December 15, 1988 and approximately \$85,795,000 on August 30, 1990 to finance the purchase of commuter rail coaches. Under the terms of the applicable agreements, the MBTA's obligation to make the annual payments on the certificates is subject to the Commonwealth's appropriation of necessary funds in its annual budget.

The certificates bear interest at rates ranging from 7.30% to 7.80% and mature as follows (amounts in thousands):

Fiscal Year Ended June 30	Principal	Interest
2003.....	\$ 1,140	\$ 353
2004.....	1,140	264
2005.....	1,135	176
2006.....	1,135	88
	<u>\$ 4,550</u>	<u>\$ 881</u>

The remaining outstanding principal balance of COPs that were defeased in-substance in prior years is \$9,075,000 at June 30, 2002.

In prior years, the MBTA defeased in-substance several General Transportation System Bonds by placing the proceeds of new bonds in an irrevocable trust fund to provide for future debt service payments on the old debt. Accordingly, the trust account asset and the liability for the defeased bonds are not included in the accompanying financial statements. On June 30, 2002, approximately \$1,800,000,000 of these bonds outstanding are considered defeased.

On February 22, 1995, Pioneer Valley Transit Authority (PVTa) (a non major component unit) issued certificates of participation of approximately \$9,930,000 to finance the purchase of buses. Under the terms of the agreement, PVTa is obligated to make annual payments on the certificates subject to the Commonwealth appropriating the necessary funds in the Authority's annual budget. As of June 30, 2002, the principal amount of certificates outstanding is \$1,228,000.

**K. Bond Issuances
Subsequent to June 30,
2002**

The following bond series' were issued subsequent to June 30, 2002, but before the date of the audit opinion (amounts in thousands):

<u>Description</u>	<u>Issue Size</u>	<u>Refunding Portion</u>	<u>Interest Rate Range (%)</u>	<u>FY of Maturities</u>
<u>Primary Government</u>				
General Obligation Bonds Consolidated Loan of 2002, Series C	\$ 1,828,230	\$ 1,329,000	4.125% - 5.5%	2010-2021
General Obligation Bonds Consolidated Loan of 2002, Series D	670,745	357,725	2.5% - 5.5%	2003-2022
General Obligation Refunding Bonds, Consolidated Loan of 2002, Series A, Delayed Delivery	446,435	446,435	5.50%	2007-2011
General Obligation Refunding Bonds, Consolidated Loan of 2002, Series B, Delayed Delivery	102,820	102,820	5%	2006
General Obligation Bonds Consolidated Loan of 2002, Series E	734,350	-	2% - 5.5%	2005-2023
General Obligation Refunding Bonds, Consolidated Loan of 2003, Series A, Delayed Delivery	108,825	108,825	5.375%	2008
College Opportunity Bonds, Series 2002A	5,970	-	Variable	2007- 2022
<u>Component Units</u>				
Massachusetts Water Pollution Abatement Trust:				
MWRA Program Bonds, Series 2002A	124,800	-	3% - 5.25%	2004-2033
Pool Program Bonds, Series 8	266,885	-	3% - 5%	2004-2033
Massachusetts Bay Transportation Authority:				
Senior Sales Tax Bonds, 2002 Series A	396,885	-	3% - 5.25%	2004-2033

9. INDIVIDUAL FUND DEFICITS

Certain funds within the Governmental Fund Type have fund deficits at June 30, 2002 as follows (amounts in thousands):

<u>Fund</u>	<u>Amount</u>
Major governmental funds:	
Local Aid.....	\$ 1,035,804
Highway Capital Projects.....	539,518
Other governmental funds:	
Federal Grants.....	6,069
Highway.....	429,317
Environmental Funds.....	63,300
General Capital Projects.....	217,580
Capital Investment Trust	957
Convention and Exhibition Center.....	277,192
Capital Improvement and Investment Trust	29,858
Capital Expenditure Reserve.....	192,874
Local Capital Projects.....	11,221
MBTA State and Local Contribution	167
Government Land Bank.....	35,097
Mosquito and Greenhead Fly Control	1,413
Board of Registration in Medicine	41
Motor Vehicle Safety Inspection	25,210

10. RETIREMENT SYSTEMS

A. Primary Government

The Commonwealth is statutorily responsible for the pension benefits for Commonwealth employees (members of the State Employees' Retirement System) and for teachers of the cities, towns, regional school districts throughout the Commonwealth and Quincy College (members of the Teachers' Retirement System, except for teachers in the Boston public schools, who are members of the State-Boston Retirement System but whose pensions are also the responsibility of the Commonwealth). The members of the retirement systems do not participate in the Social Security System.

The Commonwealth has assumed responsibility for payment of cost-of-living adjustments (COLA) for the separate (non-teacher) retirement systems of its cities, towns and counties, granted in fiscal year 1997 and prior. The Commonwealth is statutorily required to have an actuarial valuation once every three years and every two years on a GAAP basis.

B. Plan Descriptions

The *State Employees' Retirement System* (SERS) is a single employer defined benefit public employee retirement system (PERS), covering substantially all employees of the Commonwealth and certain employees of the independent authorities and agencies, including the state police officers at the Massachusetts Port Authority and the Massachusetts Turnpike Authority. The SERS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand alone financial report.

The *Teachers' Retirement System* (TRS) is an agent multiple employer defined benefit PERS. The Commonwealth is a non-employer contributor and is responsible for all contributions and future benefit requirements of the TRS. The TRS covers certified teachers in cities (except the City of Boston), towns, regional school districts and Quincy College. The TRS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand-alone financial report.

Certain Commonwealth employees and current retirees employed prior to the establishment of the State Employees' Retirement System are covered on a "pay-as-you-go" basis. During the year ended June 30, 2002, the Commonwealth's pension expenditure included payments totaling \$17,374,000 to current retirees employed prior to the establishment of the current plans and the non-contributory plans.

The *State – Boston Retirement System* (SBRS) is a hybrid multiple employer defined benefit PERS. SBRS provides pension benefits to all full-time employees upon commencement of employment with any of the various government agencies covered by SBRS. The Commonwealth is a non-employer contributor and is only responsible for the actual cost of pension benefits for SBRS participants who serve in the City of Boston's School Department in a teaching capacity (BTRS). The cost of pension benefits of the other participants is the responsibility of the City of Boston. SBRS is not administered by the Commonwealth and is not part of the reporting entity and a stand-alone financial report is not available.

The policy for post-retirement benefit increases for all retirees of the SERS, TRS, BTRS and COLA of local governments is subject to legislative approval.

Membership – Membership in SERS, TRS and BTRS as of January 1, 2002, the date of the most recent valuation, is as follows:

	<u>SERS</u>	<u>TRS</u>	<u>BTRS</u>
Retirees and beneficiaries			
currently receiving benefits.....	44,313	34,970	2,593
Terminated employees entitled to benefits but not yet receiving them....	2,842	N/A	128
Subtotal.....	47,155	34,970	2,721
Current employees:			
Vested*.....	45,566	46,637	3,621
Non-vested*.....	42,952	42,790	2,656
Subtotal.....	88,518	89,427	6,277
Total.....	135,673	124,397	8,998

C. Benefit Provisions

Massachusetts General Laws established uniform benefit and contribution requirements for all contributory PERS. These requirements provide for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, and group creditable service, and group classification. The authority for amending these provisions is with the Legislature.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65; for certain hazardous duty and public safety positions, normal retirement is at age 55.

D. Funding Progress

During FY01, the Legislature passed Chapter 114 of the Acts of 2000, which modified Chapter 32 of the General Laws. This modification became effective on July 1, 2001. In Chapter 114, teachers who are members of the State Teachers Retirement System, or teachers who are members of the State – Boston Retirement System before 1975, who resigned or took an unpaid leave of absence because of maternity leave will be allowed to “buy back” into the fund up to a maximum of four years. The member must pay the amount determined by the Retirement Board by December 31, 2001 to qualify, as long as the member has worked longer than ten years. If the member completes ten years of service after December 31, 2001, payment can be made within 18 months of completion of ten years of service. In addition, the law creates a superannuation retirement benefit program for all teachers hired on or after July 1, 2001. This program has a contribution rate of 11 percent of regular compensation. To be eligible for the alternative benefit at retirement, the teacher must have completed thirty years of eligible service. All previous members may elect to participate in the program, as long as they participate with the equivalent of a minimum of five years of employee contributions at the new rate. If the member retires before five years, the teacher must pay into the system, the amount that would have been paid in one lump sum, or in installments as the Board may prescribe. The alternative benefit is calculated as the percentage of average compensation determined under the current formula increased by 2% of the average annual compensation for each full year of service in excess of 24 years. The election to participate is irrevocable.

The SERS, TRS and BTRS actuarial determined contributions were computed as part of the actuarial valuation as of January 1, 2001. These assumptions remained the same as of the January 1, 2002 valuation. The Commonwealth has revised actuarial assumptions used in the calculation of contribution requirements and Unfunded Actuarial Liability (UAL.) The revised actuarial assumptions are the result of an experience study commissioned by the Commonwealth for the period 1995 to 1999 concluded in FY01. The Commonwealth has fully phased-in its UAL from a market value of assets to an actuarial valuation of assets. The actuarial value of assets used to derive the UAL from January 1, 1990 to January 1, 1996 reflects the market value of plan assets. To reduce the potential volatility of the market value approach, in the January 1, 1998 actuarial valuation, the Commonwealth began implementing a method that averages realized and unrealized asset gains and losses over 5 years.

Therefore, gains and losses in a given year are recognized over a five-year period. On January 1, 1998, the Commonwealth began phasing in this methodology and used 97% of market value as the actuarial value of assets. This methodology was fully phased in as of January 1, 2001. The most

significant assumptions for the actuarial valuation are investment return and rate of salary increase. The valuation as of January 1, 2002 assumes an investment return rate of 8.25% per year. The salary increase is based on years of service and it varies by age and service groups. Other assumptions include mortality, disability, turnover and retirement rates, along with cost of living increase.

The following table presents the schedule of funding progress as presented in the eight most recent actuarial valuations at the date indicated (amounts in thousands):

Actuarial Valuation as of January 1	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability (UAL)	Funded Ratio %	Annual Covered Payroll *	UAL as a % of Covered Payroll
State Employees' Retirement System (SERS)						
2002	\$ 15,002,000	\$ 15,961,000	\$ 959,000	94.0 %	\$ 4,034,000	23.8 %
2001	13,922,000	15,170,000	1,248,000	91.8	3,700,000	33.7
2000	13,364,000	14,138,000	773,000	94.5	3,472,000	22.3
1998	9,914,000	11,361,000	1,447,000	87.3	3,111,000	46.5
1996	7,366,000	9,441,000	2,075,000	78.0	2,989,000	69.4
1995	5,879,000	8,602,000	2,723,000	68.3	2,992,000	91.0
1993	5,071,000	8,738,000	3,667,000	58.0	2,919,000	125.6
1992	4,699,000	7,303,000	2,604,000	64.3	2,638,000	98.7
Teachers' Retirement System (TRS)						
2002	15,712,000	20,620,000	4,908,000	76.2	4,264,000	115.1
2001	14,390,000	18,170,000	3,779,000	79.2	4,072,000	92.8
2000	13,681,000	16,420,000	2,739,000	83.3	3,704,000	73.9
1998	10,170,000	13,095,000	2,925,000	77.7	3,175,000	92.1
1996	7,553,000	10,252,000	2,699,000	73.7	2,810,000	96.0
1995	6,014,000	9,712,000	3,698,000	61.9	2,667,000	138.7
1993	5,142,000	8,921,000	3,779,000	57.6	2,428,000	155.6
1992	4,784,000	8,706,000	3,922,000	55.0	2,032,000	193.0
Boston Teachers (BTRS)						
2002	984,000	1,756,000	772,000	56.0	370,000	208.6
2001	918,000	1,502,000	583,000	61.1	304,000	191.8
2000	860,000	1,381,000	521,000	62.3	285,000	182.8
1998	699,000	1,219,000	520,000	57.3	285,000	182.5
1996	549,000	1,025,000	476,000	53.6	274,000	173.7
1995	438,000	833,000	395,000	52.6	232,000	170.3
1993	370,000	743,000	373,000	49.8	206,000	181.1
1992	342,000	759,000	417,000	45.1	184,000	226.6

* - The covered payroll amounts approximate the employer payroll.

E. Pension Actuarial Valuation

The Commonwealth's pension actuarial valuation was performed as of January 1, 2002 pursuant to Chapter 32 of the General Laws of the Commonwealth of Massachusetts and based on the plan provisions at that time.

F. Contributions Required and Contributions Made

The Commonwealth was financially responsible for the COLA granted to participants in the 104 retirement systems of cities, towns and counties in fiscal year 1997 and prior fiscal years. Chapter 17 of the Acts of 1997 effective for fiscal year 1998 transferred the responsibility for funding COLAs for separate (non-teacher) retirement systems of cities and towns to the respective system. Any future COLA granted by the Legislature to employees of these plans will be the responsibility of the individual system. The individual employer governments are also responsible for the basic pension benefits. The retirement systems are not administered by the Commonwealth and are not part of the reporting entity. The actuarial accrued liability for COLA as of January 1, 2002 was \$730,000,000.

The retirement systems' funding policies have been established by Chapter 32 of the Massachusetts General Laws. The Legislature has the authority to amend these policies. The annuity portion of the SERS, TRS and BTRS retirement allowance is funded by employees, who contribute a percentage of their regular compensation – 5% for those hired before January 1, 1975, 7% for those hired

from January 1, 1975, through December 31, 1983 and 8% for those hired on or after January 1, 1984, plus an additional 2% of compensation above \$30,000 per year for those hired on or after January 1, 1979. Regular employees and state police hired after June 30, 1996 are required to contribute 9% and 12% respectively of their regular compensation plus an additional 2% of compensation above \$30,000 per year. Costs of administering the plan are funded out of plan assets.

The Commonwealth's contribution for the pension benefit portion of the retirement allowance of SERS and TRS and required payments to cover BTRS and COLA contributions were originally established on a "pay-as-you-go" basis. As a result, amounts were appropriated each year to pay current benefits, without a systematic provision to fully fund future liabilities already incurred. Beginning in fiscal year 1988, the Commonwealth enacted the Pension Reform Act of 1987 and addressed the unfunded liability of SERS, TRS and its participation in SBRS and its COLA obligation. Chapter 32, Section 22C of General Laws enacted in 1998 calls for the payment of normal cost plus an amortization payment of UAL such that the UAL is reduced to zero by June 30, 2018.

This legislation also directs the Secretary of Administration and Finance to prepare a funding schedule to meet these requirements, and to update this funding schedule every three years on the basis of new actuarial valuation reports prepared under the Secretary's direction. Any such schedule is subject to legislative approval. If a schedule is not so approved, payments are to be made in accordance with the most recently approved schedule. The current legislatively approved funding schedule, a valuation as of January 1, 1999, was filed by the Secretary of Administration and Finance on March 1, 2000 has been deemed approved by the Legislature. Under the current schedule proposed on March 1, 2002, the amortization payments are designed to eliminate the unfunded liability by fiscal year 2023. Contributions by the Commonwealth of \$795,782,000 were made during the fiscal year ended June 30, 2002. Of this amount \$49,772,000 represents payments for COLA granted to participants in retirement systems of cities, towns and counties.

GAAP requires that pension expenditures (costs) be based on an acceptable actuarial cost method and that they be not less than:

- Normal cost plus amortization of net pension obligation cost
- Interest and amortization on any unfunded prior service costs

On May 17, 2002, the Governor signed into law a bill that extended the Commonwealth's pension funding schedule to 2023, and reduced the FY02 pension appropriation.

The funding schedule discussed above follows an acceptable actuarial funding methodology to compute normal cost and the unfunded accrued actuarial liability.

The following table presents the schedule of employer contributions (amounts in thousands):

Actuarial Valuation as of January 1	Annual Required Contribution (ARC)	Interest on NPO	Amortization of NPO	Pension Cost	Actual Contribution Made	Net Pension (Obligation) Asset (NPO)	% of ARC Contributed	% of Pension Cost Contributed
State Employees' Retirement System								
2002	\$ 215,795	\$ (111,506)	\$ (92,152)	\$ 196,441	\$ 266,660	\$ 1,421,811	124	% 136
2001	275,204	(109,731)	(133,387)	298,861	320,381	1,351,592	116	107
2000	352,084	(108,400)	107,190	350,873	367,000	1,330,071	104	105
1999	319,454	(103,188)	98,556	314,822	378,000	1,313,944	118	120
1998	261,255	(83,446)	77,180	254,989	494,289	1,250,766	189	194
1997	246,037	(65,478)	41,889	222,448	463,590	1,011,466	188	208
1996	232,158	(46,918)	29,523	214,763	433,114	770,324	187	202
1995	249,640	(31,639)	19,614	237,615	417,361	551,973	167	176
1994	266,564	(18,448)	9,152	257,268	398,900	372,227	150	155
1993	243,587	(5,539)	2,694	240,742	402,100	230,595	165	167
Teachers' Retirement System								
2002	411,225	(82,377)	(68,079)	396,927	410,143	1,011,729	100	103
2001	475,053	(78,498)	(95,421)	491,976	539,000	998,513	113	110
2000	480,873	(79,487)	78,599	479,985	468,000	951,489	97	98
1999	373,777	(70,312)	67,155	370,620	481,826	963,474	129	130
1998	315,474	(59,126)	54,686	311,034	446,619	852,267	142	144
1997	245,426	(44,832)	28,681	229,275	418,519	716,682	171	183
1996	232,403	(30,311)	19,073	221,165	392,003	527,439	169	177
1995	277,343	(24,002)	14,880	268,221	342,441	356,601	123	128
1994	247,460	(15,975)	7,925	239,410	322,100	282,381	130	135
1993	225,838	(9,946)	4,837	220,729	296,100	199,691	131	134
Boston Teachers Retirement System								
2002	940,003	(67)	(56)	93,992	51,833	41,343	6	55
2001	66,820	1,542	1,875	66,488	86,000	815	129	129
2000	58,266	448	(443)	58,271	45,000	18,697	77	77
1999	53,453	(989)	944	53,409	36,000	5,426	67	67
1998	48,795	(2,114)	1,995	48,636	35,000	11,983	72	72
1997	34,621	(2,082)	1,332	33,871	35,000	25,619	101	103
1996	32,908	(1,860)	1,171	32,219	34,822	24,490	106	108
1995	28,168	(1,816)	1,126	27,478	28,000	21,887	99	102
1994	22,448	(1,216)	603	21,835	28,000	21,365	125	128
1993	20,463	(650)	316	20,129	27,200	15,200	133	135

**G. Post-retirement Health
Care and Life
Insurance Benefits**

The total contributions required for SERS, TRS and SBRS are based on the entry age normal cost method using the same actuarial assumptions used to compute the net pension obligation.

In addition to providing pension benefits, under Chapter 32A of the Massachusetts General Laws, the Commonwealth is required to provide certain health care and life insurance benefits for retired employees of the Commonwealth, housing authorities, redevelopment authorities, and certain other governmental agencies. Substantially all of the Commonwealth's employees may become eligible for these benefits if they reach retirement age while working for the Commonwealth. Eligible retirees are required to contribute a specified percentage of the health care benefit costs which is comparable to contributions required from employees. The Commonwealth is reimbursed for the cost of benefits to retirees of the eligible authorities and non-state agencies. The Commonwealth recognizes its share of the costs of

providing these benefits when paid. These payments totaled approximately \$236,041,000 for the fiscal year ended June 30, 2002. There are approximately 49,900 participants eligible to receive benefits at June 30, 2002.

11. LEASES

Primary Government – Governmental Activities

In order to finance the acquisition of equipment, the Commonwealth has entered into various lease/purchase agreements, including tax-exempt lease purchase (TELP) agreements, which are accounted for as capital leases. Lease agreements are for various terms and contain clauses indicating that their continuation is subject to appropriation by the Legislature. At June 30, 2002, the Commonwealth's aggregate outstanding liability under capital leases, the present value of the net minimum lease payments, totals approximately \$91,146,000. This liability is reported as a Long-Term obligation in both the governmental and business-type activities. Equipment acquired under capital leases and included as fixed assets totaled approximately \$110,562,000.

The Commonwealth has numerous operating lease agreements for real property and equipment with varying terms. These agreements contain provisions indicating that continuation is subject to appropriation by the Legislature.

Business - Type Activities – University and Colleges information – At June 30, 2002, aggregate outstanding liability under capital leases, the present value of the net minimum lease payments, totaled approximately \$79,880,000. Equipment acquired under capital leases is included in University and College Fund fixed assets.

The Colleges and the University lease real property and equipment under numerous operating lease agreements for varying terms.

The following schedule summarizes future minimum payments under non-cancelable leases for Governmental activities and for the Colleges and University – reported as a business-type activity, for the fiscal year ended June 30, 2002 (amounts in thousands):

Primary Government

Fiscal Year Ended June 30	Governmental Activities				Business - Type Activities			
	Capital Leases		Operating Leases	Total	Capital Leases		Operating Leases	Total
	Principal	Interest			Principal	Interest		
2003	\$ 24,472	\$ 3,145	\$ 135,336	\$ 162,953	\$ 16,756	\$ 3,909	\$ 29,738	\$ 50,403
2004	20,177	2,765	108,994	131,936	14,735	3,033	28,044	45,812
2005	17,627	2,333	89,449	109,409	11,414	2,320	25,212	38,946
2006	12,336	1,632	50,063	64,031	9,743	1,758	22,184	33,685
2007	8,307	1,098	22,135	31,540	9,462	1,351	20,669	31,482
2008 - 2012	8,227	1,090	58,926	68,243	17,173	1,498	330,389	349,060
2013 - 2017	-	-	-	-	429	-	1,279	1,708
2018 - 2022	-	-	-	-	129	-	506	635
Total lease obligations.....	91,146	12,063	464,903	568,112	79,841	13,869	458,021	551,731
Less: current portion:	(24,472)	(3,145)	(135,336)	(162,953)	(16,756)	(3,909)	(29,738)	(376,309)
Long - term lease obligations .	\$ 66,674	\$ 8,918	\$ 329,567	\$ 405,159	\$ 63,085	\$ 9,961	\$ 428,284	\$ 175,422

Discretely Presented Component Units –

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of net minimum lease payments as of June 30, 2002 (amounts in thousands):

Fiscal Year Ended June 30	Massachusetts Bay Transportation Authority	Nonmajor Component Units	Total
2003	\$ 46,773	\$ 717	\$ 47,490
2004	48,474	717	49,191
2005	41,383	716	42,099
2006	42,418	713	43,131
2007	47,829	711	48,540
2008 - 2012	296,491	-	296,491
2013 - 2017	224,691	-	224,691
2018 - 2022	94,080	-	94,080
Lease obligations	842,139	3,574	845,713
Less: Interest portion:	(293,666)	(478)	(294,144)
Present value of minimum			
lease payments	548,473	3,096	551,569
Less: current portions	(14,489)	(556)	(15,045)
Long - term lease obligations	\$ 533,984	\$ 2,540	\$ 536,524

The MBTA has entered into several sale-leaseback agreements with major financial institutions, covering equipment and rolling stock, which has been accounted for as operating leases. These leases expire through fiscal year 2013. Upon termination, the MBTA may purchase the equipment and rolling stock at prices equal to the lesser of a stated percentage (40%-70%) of the lessor's original purchase price or residual fair market value, as defined.

The MTA has operating leases for administrative office space and automatic toll collection equipment. These operating leases expire on various dates through June 2004. Lease expenses charged to the Massachusetts Turnpike and Sumner-Callahan-Williams Tunnels were approximately \$948,000 of which \$854,000 was paid to the Commonwealth for office space in a state-owned building.

The MTA leases property and air rights to others. The MTA earned approximately \$25,760,000 in rental income of which \$13,952,000 was received for restaurant, concessions and service station rentals. Rental income for the next five years is expected to approximate \$22,975,000 per year based on leases currently in effect.

The Economic Development Entities and the RTAs have operating leases for office space.

The future minimum rental payments required under operating leases having initial or remaining non-cancelable lease terms in excess of one year are as follows (amounts in thousands):

Fiscal Year Ended June 30	Massachusetts Bay Transportation Authority	Massachusetts Turnpike Authority	Nonmajor Component Units	Total
2003	\$ 14,071	\$ 855	\$ 3,690	\$ 18,616
2004	13,651	869	1,856	16,376
2005	12,804	890	844	14,538
2006	13,070	455	692	14,217
2007	13,439	-	160	13,599
2008 - 2012	63,423	-	336	63,759
2013 - 2017	7,520	-	336	7,856
2018 - 2022	-	-	218	218
2023 - 2027	-	-	74	74
2028 - 2032	-	-	19	19
Total lease obligations	<u>\$ 137,978</u>	<u>\$ 3,069</u>	<u>\$ 8,225</u>	<u>\$ 149,272</u>

12. COMMITMENTS

Primary Government –

Governmental Funds - As part of the General Appropriation Act of 2000 (Chapter 127 of the Acts of 1999) the funding mechanism for the net cost of service and other costs of the Massachusetts Bay Transportation Authority (MBTA) was changed. The change was effective July 1, 2000. Under the new funding method (Forward Funding), the MBTA's costs will be funded on a current basis. This method apportions a "dedicated sales tax" amounting to 1% of applicable sales in the Commonwealth, directly to the MBTA. The dedicated sales tax will be equal to the greater of the amount raised by the sales tax or \$645,000,000, (the base revenue,) subject to an adjustment for inflation, capped at 3% annually. The dedicated sales tax is equal to the greater of the amount raised by the sales tax or the base revenue subject to an adjustment for inflation, capped at 3% annually. For fiscal 2003, the base revenue is \$684,280,500.

Regional Transit Authorities - Under Chapter 161B of the General Laws, the Commonwealth is obligated to provide annual subsidies to certain regional transit authorities for contract assistance, debt service assistance and their net cost of service deficiencies. The Commonwealth recovers a portion of these payments through assessments to the cities and towns served. During fiscal year 2002, net expenditures were \$17,602,000. In addition, for fiscal year 2002, the Commonwealth appropriated \$18,423,000 to the regional transit authorities to cover net costs of service for the calendar year ended December 31, 2001.

MBTA and Other Authorities - The Commonwealth continues to guarantee MBTA debt issued prior to June 30, 2000 but no longer provides contract assistance on this debt. The amount of debt issued prior to June 30, 2000 that remains outstanding at June 30, 2002 is \$3,264,345,000.

The MBTA's forward funding legislation provides for the MBTA to issue general obligation, revenue or other debt secured by a pledge or conveyance of all or a portion of revenues, receipts or other assets or funds of the MBTA. This new debt is not backed by the full faith and credit of the Commonwealth.

Finally, the MBTA will not receive any principal or interest subsidies from the Commonwealth for the repayment of either the prior debt or new debt of the MBTA beyond the pledged revenues.

In addition to the MBTA, the Commonwealth guarantees debt of a number of public authorities. At June 30, 2002, the aggregate outstanding debt for which the Commonwealth is obligated to provide contract assistance support is approximately \$169,312,000 long term and \$96,856,000 short term.

In addition, the Commonwealth guarantees the debt of certain local governments and public higher education building authorities but does not provide contract assistance. The guaranteed long-term debt outstanding at June 30, 2002 was approximately \$381,794,000.

At June 30, 2002, the Commonwealth had commitments of approximately \$1,657,409,000 for ongoing construction projects. The majority relate to construction funding for the Central Artery/Tunnel Project. The Central Artery/Tunnel Project continues to anticipate federal participation and payments from the Massachusetts Turnpike Authority (MTA) and the Massachusetts Port Authority (MassPort).

Saltonstall Building – The Commonwealth has authorized MassDevelopment to redevelop the Saltonstall State Office Building. Under the provisions of the legislation relating to the building's redevelopment, the building is to be leased by MassDevelopment for a lease term up to 50 years, with extension terms permitted for an aggregate of 30 more years. MassDevelopment will renovate the building and lease half of it back to the Commonwealth for office space and related parking (for a comparable lease term.) The remainder of the building is to be redeveloped as private office space, as well as private housing units and retail establishments.

Central Artery / Tunnel Project – The Commonwealth is currently engaged in the most expensive public construction project in the history of the United States, the Central Artery / Tunnel Project (CA/T). The project will depress the Central Artery (Interstate 93) through downtown Boston and connect the Massachusetts Turnpike (Interstate 90) through a tunnel under Boston Harbor directly to Logan Airport. In addition to Commonwealth debt and funds from the Federal Government, the Massachusetts Turnpike Authority and Port Authority have contributed to the cost of construction. Once completed the assets will be transferred to these entities for operation and maintenance. The Central Artery / Tunnel Project is the largest single component of the Commonwealth's capital program according to the finance plan filed as of August 31, 2002. The current cost estimate is \$14.625 billion. The plan includes a maximum obligation of \$8.549 billion from the federal government. As of September 30, 2002, the project was 84% complete. Project milestones have been reviewed to include I-90 opening and I-93 Northbound opening in January 2003 and I-93 Southbound opening in January 2004.

In connection with the Central Artery / Tunnel Project, on May 8, 2000, the State Treasurer's office was advised that the staff of the Securities and Exchange Commission (SEC) is conducting a formal investigation in the matter of "Certain Municipal Securities/Massachusetts Central Artery (B-1610)." This is pursuant to a formal order of private investigation issued by the SEC. The attorneys on behalf of the Commonwealth believe that the likelihood of loss by the Commonwealth is remote.

All payments pursuant to the agreements have been made from the MTA, except for the \$4,000,000 being held in escrow, pending an eminent domain settlement. MassPort is due to make payments for the project under the agreements from fiscal 2003 through 2005 in the amounts of \$104,000,000, \$50,000,000 and \$51,000,000 in those respective fiscal years.

Pension Trust Funds – At June 30, 2002, PRIT had outstanding commitments to invest approximately \$858,262,000 in real estate, and approximately \$1,714,824,000 in alternative investments. The fair value of the proposed investment commitments approximates their stated value.

PRIT regularly trades financial instruments with off-balance sheet risk in the normal course of its investing activities to assist in managing exposure to market risks such as interest rates. These financial instruments include forward foreign currency exchange contracts and financial futures contracts.

PRIT may enter into “TBA” (to be announced) purchase or sale commitments to purchase or sell mortgage backed securities. The risk of loss is in addition to the risk of decline in the value of PRIT’s other assets. See PRIT footnotes to financial statements for more detail.

Discretely Presented Component Units -

Chapter 152 of the Acts of 1997 provides \$609,400,000 for the construction of a Convention and Exhibition Center that will provide 600,000 square feet of exhibit space at a site in South Boston. The Boston Redevelopment Authority (BRA) is authorized and directed by the legislation to acquire the land, properties, and rights related to the proposed construction site. Once this is accomplished, the Massachusetts Convention Center Authority (MCCA) will oversee construction of the new facility. The MCCA will operate the new center, along with the Hynes Convention Center, the Boston Common Garage, and the Springfield Civic Center.

As of June 30, 2002, the Massachusetts Water Pollution Abatement Trust (MWPAT) has agreed to provide loans of \$173,000,000 to various local government units to be funded with grant awards.

Massachusetts Housing Partnership Fund (MHP) has executed twenty-eight loan agreements with thirteen banks totaling approximately \$450,003,000 pursuant to the Massachusetts Nationwide Interstate Banking and Community Reinvestment Act. Related to that, MHP has funding commitments outstanding for funds not yet advanced of approximately \$50,259,000 at June 30, 2002.

The MTA entered into construction contracts for the Metropolitan Highway system and the Western Turnpike with various construction and engineering companies. Construction contracts outstanding at December 31, 2001 approximated \$13,000,000.

13. CONTINGENCIES

Primary Government -

Governmental Funds – The General Fund services claims for all risks of loss for which the Commonwealth is exposed, other than workers’ compensation and employee group health and life insurance, which are managed in its general operations. A number of lawsuits are pending or threatened against the Commonwealth which arose from the ordinary course of operations. These

include claims for property damage and personal injury, breaches of contract, condemnation proceedings and other alleged violations of law. For cases in which it is probable that a loss will be incurred and the amount of the potential judgment can be reasonably estimated, or a settlement or judgment has been reached but not paid, the Attorney General estimates the liability to be approximately \$76,500,000 as of June 30, 2002. The General Fund allocates the cost of providing claims servicing and claims payment by charging a premium to each fund based on claims paid during the year.

The Commonwealth receives significant financial assistance from the federal government. Entitlement to these resources is generally conditional upon compliance with terms and conditions of the grant or reimbursement agreements and with applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all federal financial assistance is subject to financial and compliance audits. Any disallowances become liabilities of the fund that received the assistance. As of June 30, 2002, the Commonwealth estimates that liabilities, if any, which may result from such audits are not material.

The Commonwealth's abandoned property law requires deposit of certain unclaimed assets into a managed Fiduciary Fund. These unclaimed assets, less \$4,987,000 that is expected to be reclaimed and paid in fiscal year 2003, are to be remitted to the General Fund each June 30, where it is included as a transfer. Amounts remitted during fiscal year 2002 totaled approximately \$87,757,000. Since inception, approximately \$1,056,364,000 has been remitted. This represents a contingency, because claims for refunds can be made by the owners of the property.

Tobacco Settlement – A Master Settlement Agreement (MSA) was executed in November of 1998 between five tobacco companies and 46 states, including the Commonwealth. The MSA called for, among other things, annual payments to the states in perpetuity. These payments have been estimated to total more than \$200 billion over the first 25 years, subject to various offsets, reductions, and adjustments. In fiscal year 2002, the Commonwealth received approximately \$304,518,000 or 91% of the estimated amounts shown in the agreement. Of that amount approximately \$152,259,000 was transferred to the Tobacco Settlement Fund to finance health care costs. The remaining receipts from fiscal 2002 are held for future use. However, the fiscal 2003 budget earmarked the entire settlement receipts for the year to be deposited into the Tobacco Settlement Fund to pay for current year costs. A number of the outside attorneys for the Commonwealth have filed suit against the Commonwealth for the difference between the balance that had been previously awarded to the attorneys to be paid over time by the tobacco companies (and not the Commonwealth's award) for fees and 25% of the Commonwealth's tobacco settlement payments. In an early ruling in the case, the Court found that the attorney's arguments may ultimately inure to the benefit of all five law firms that represented the Commonwealth in the legal action against tobacco manufacturers. The effect of this ruling is to increase the potential exposure for the Commonwealth to approximately \$1.3 billion.

Central Artery/Tunnel Project – Owner Controlled Insurance Program (OCIP) – The Commonwealth of Massachusetts has assumed responsibility for providing worker's compensation and general liability insurance for all eligible contractors and subcontractors working on the Central Artery/Tunnel Project by establishing an Owner Controlled Insurance Program in 1992.

In 1996 the Highway Department established a trust managed and administered by an independent third party (trustee) to protect a portion of the assets set aside with the insurance carrier to fund project liabilities.

The amounts in the Trust are restricted by its terms and cannot be used for other purposes. The withdrawals, other than those to cover costs specified by the Trust Agreement, require mutual consent. Any amounts that remain in the Trust after all losses and other obligations of the Project are paid will be repaid to the Project for distribution in accordance with funding agreements with the federal government. There are currently discussions pending under which the Trust assets would become “defederalized” and therefore no longer restricted as to the ultimate distribution at the end of the Project.

During fiscal 2002, certain assets held by an insurance company on behalf of the owner controlled insurance program (OCIP) for the payment of general liability claims were included in the financial statements. The beginning balance has been restated to reflect these assets, previously unrecorded receivable balances identified as the result of an audit of the workers’ compensation and general liability program, and a change in accounting estimate made by management relating to incurred but not yet reported claims. As of June 30, 2002 the balances held outside of the trust amount to \$59.3 million.

The Project’s OCIP activity is reported as a minor governmental (capital project) fund. The “Claims and Judgements liabilities” reported within the fund therein represents the Project’s liabilities as estimated by an independent actuary for incurred losses projected to their ultimate value as of the end of the fiscal year for fiscal 2002. The remaining liability is reported as part of the non-current liability in the statement of net assets.

The OCIP’s assets are to be available to pay the obligations under the Owner Controlled Insurance Programs. These insurance programs are presently structured as retrospectively rated insurance programs with retained loss limits of \$1,000,000 per claim, \$3,000,000 per occurrence for worker’s compensation and \$2,000,000 per enrolled contractor or other named insureds, \$6,000,000 per occurrence for general liability coverage. The Commonwealth is responsible for loss costs up to these amounts.

The estimated Claims and Judgements liability for occurrences through June 30, 2002 is \$120,900,000, of which \$31,800,000 is presented as a current liability in the minor governmental fund, while the remaining \$89,100,000 is presented on the statement of net assets. This amount is based on the results of a review performed by an independent actuarial firm retained by the Project, and it represents an estimate of liabilities incurred based on past experience for claims reported and not reported as of June 30, 2002. The estimate of \$120,900,000 does not reflect the maximum potential obligation of the Project to the end of the Project.

The United States Department of Justice has an ongoing investigation of the OCIP. Also, as part of their approval process of the Project’s Finance Plan, the U. S. Department of Transportation Office of the Inspector General reviews the OCIP. The Project updated its October 2001 plan in March 2002, by agreeing to remove \$133 million in federal funds from the trust. This process was completed in July 2002. In August 2002 an additional \$81 million in federal funds were removed to defederalize the OCIP Trust.

Claims and Judgments - The following amounts were recognized as of June 30, 2002 (amounts in thousands):

	Balance as of July 1, 2001	Additions	Reductions	Balance as of June 30, 2002
Short-term.....	\$ 27,000	\$ 112,200	\$ (27,000)	\$ 112,200
Long-term.....	113,000	86,000	(113,000)	86,000
	<u>\$ 140,000</u>	<u>\$ 198,200</u>	<u>\$ (140,000)</u>	<u>\$ 198,200</u>

Discretely Presented Component Units - The MBTA reserves self-insurance liabilities as claims and judgements as of June 30, 2002. Changes in the self-insurance reserves in fiscal 2002 and 2001 were as follows (amounts in thousands):

	2002	2001
Liability, beginning of year.....	\$ 69,476	\$ 60,846
Current year claims and changes in estimates.....	114,651	90,958
Claims payments.....	(97,483)	(82,328)
Liability, end of year.....	<u>\$ 86,644</u>	<u>\$ 69,476</u>

Other Contingencies - The Massachusetts Turnpike Authority has obtained health coverage for most employees through various commercial health maintenance organizations. The health coverage for certain other employees, as well as coverage for job-related injuries to all employees, is self-insured by the Authority, with risks managed internally. At December 31, 2001, the accrual for outstanding claims under these programs, including claims incurred but not reported, was approximately \$8,511,000.